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The Value Relevance of Key Audit Matters



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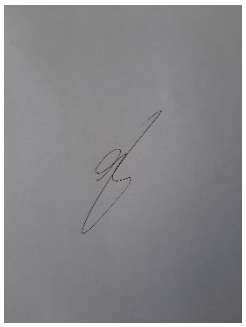
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Declaration

I hereby declare that this research report is my own original work and that all sources have been accurately reported and acknowledged. It is submitted for the degree of Master of Commerce (in the field of Accounting) to the University of the Witwatersrand, Johannesburg. This research report has not been submitted for any degree or examination at this or any other university.



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Definition of Terms

Abbreviation	Description
IAASB	International Auditing and Assurance Standards Board
IAS	International Accounting Standard
IFRS	International Financial Reporting Standard
ISA	International Standards on Auditing
JSE	Johannesburg Stock Exchange
KAM	Key Audit Matter
SOX	Sarbanes-Oxley Act

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Abstract

Key audit matters (KAMs) are a disclosure requirement per the International Standards on Auditing (ISA) 701 for companies listed on the Johannesburg Stock Exchange (JSE). KAMs relate to those matters encountered during the audit which were of most significance, and which must be disclosed separately in the audit report. The current literature on KAMs is primarily of a qualitative nature. This dissertation attempts to contribute to the existing literature by providing a quantitative lens to the value relevance of KAMs. The objective of KAM paragraphs in audit reports is to provide more relevant information to users of the report. To assess this objective, a value relevance study was conducted to evaluate whether KAM disclosures were providing relevant information to users of the audit report. The data used in the study were collected from the annual reports of the companies within the sample. The market to book ratio of a firm was used as a proxy for value relevant information. A multiple regression was conducted to investigate whether the number of KAMs or category of KAMs were value relevant to users of the audit report. The findings in the research indicate that the number of KAMs disclosed in the audit report is not seen as value relevant, whereas categories of KAMs relating to the profitability and cash flows of the firm were identified as value relevant. Future research could assess KAM disclosures relating to companies not primarily listed on the JSE, as well as unlisted and public sector entities.

Key Words

Key audit matters, value relevance, audit quality, audit reporting, and disclosure.

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CHAPTER 1: INTRODUCTION

“Strange transactions”, “erratic cash flow”, and “huge debt”, were some of the findings which Bethany McLean found in her investigations into Enron during a post-mortem interview concerning the company (Kurtz, 2002). The collapse of Enron has been one of the most significant audit failures in the auditing profession’s history, and one which had shaken investor confidence in financial reporting the world over (Danescu & Spatacean, 2018). In a South African context, the recent audit failures relating to Steinhoff and African Bank illustrate the need for added transparency surrounding the audit of financial information (Niselow, 2018; Rossouw & Styan, 2019).

KAMs have been instituted by the International Auditing and Assurance Standards Board (IAASB) to provide greater transparency in the auditing of financial information. The objective of KAMs is to enhance the confidence that users’ of the audit report and financial statements (hereafter referred to as users) place on the integrity of financial information contained within the financial statements of a company (Reintjes, 2015b). KAMs have been described as the most significant innovation of audit reporting in recent times (PriceWaterhouseCoopers, 2015; Reintjes, 2015a; Segal, 2019).

1.1 Context of the study

The auditing profession has long been a valuable service profession respected within commercial society for its ability to ensure accountability of management in upholding shareholder’s interests (Pentland, 2000). The auditing profession in South Africa has been highly regarded worldwide, boasting one of the highest ratings for accounting practices and audit reporting (Bowes, Lundy, & Pennington, 2004; Maroun & Gowar, 2013; Segal, 2017).

The market gains a reasonable amount of certainty concerning the financial affairs of a company if a company has been subjected to an audit (ACCA, 2010). Economic transactions with the company are entered into with some degree of confidence as investing or finance decisions are perceived to be based on trustworthy data. Without the attest function that the audit profession provides, the market and economy as a whole, would be dysfunctional as financial information would be less reliable (Danescu & Spatacean, 2018; Masdor & Shamsuddin, 2018).

An audit is a process which investigates the financial accounts of a company to ensure that the data presented is free from misstatements in all material respects (IAASB, 2009b). In South Africa, state-owned companies, public companies, and companies which hold a public interest score of over 350 are required by the Companies Act 71 of 2008 to be audited. An audit report is produced at the conclusion of the audit which contains, among other sections,

the audit opinion. The audit opinion is a statement which conveys whether the company, which has been subjected to an audit, has presented their financial statements fairly and without any material misstatements (IAASB, 2015b).

The auditing profession is geared to provide users with relevant data which can be used to inform investment and other decisions. The main document which provides this information is the audit report, which contains the audit firm, the audit opinion, KAMs, and other information which may be relevant to a user's understanding of the entity (IAASB, 2015b). The audit report is the final product of the audit process. Paragraphs included in the audit report are directed at providing relevant information to users (IAASB, 2015b). Examples of the above disclosure paragraphs include the emphasis of matter, other matters, and KAM sections respectively.

The expectation gap represents the disconnect between what the responsibility of the auditor is versus the public expectation of the duties which the auditor is expected to perform. The KAM section in the audit report has been implemented to provide users with useful information regarding disclosures around key aspects of the audit (Reintjes, 2015a). With the introduction of the KAM section, the expectation gap may be reduced as more information is disclosed regarding the operations of an audit, which enhances the transparency of the audit and highlights the role of the auditor (Nwaobia et al., 2016; Sirois et al., 2018).

The 15th of December 2016 marked an important period in the South African auditing profession, as audit reports concerning companies listed on the JSE with financial year ends on or after 15 December 2016 were mandated to include a KAM section (IAASB, 2015c). The objective of the KAM paragraphs are to provide added transparency to the audit of the financial statements of JSE listed companies (IAASB, 2015c; Segal, 2019). KAMs are those matters encountered during the audit which were of most significance, and which must be disclosed separately in the audit report as required by ISA 701 (IAASB, 2015c). KAMs were developed to enhance the relevance of the audit report and provide valuable information to users. This was intended to be achieved by disclosing key areas of the audit, thereby enhancing the understandability of the audit process regarding each KAM item (IAASB, 2015c; Reintjes, 2015a; Segal, 2017). Although ISA 701 (2015c) is a relatively new standard, its relevance is of significant interest in assessing whether the desired outcome of providing more relevant information in the audit report has been achieved.

The intended objective of ISA 701 was to provide users with relevant information. The relevance of information has often been assessed through conducting value relevance studies (Ali & Hwang, 2000; Holthausen & Watts, 2001). Value relevance studies are primarily concerned with investigating the empirical relationship between accounting information, being financial or non-financial, and the stock market value of equity (Barth, Beaver, & Landsman,

2000; Holthausen & Watts, 2001). As such, the relevance of KAMs may be assessed by conducting a value relevance study on the KAM disclosures contained within the audit report.

1.2 Research problem

The research problem under investigation is whether the added disclosures under the KAM section in the audit report is providing users with valuable information to enhance the relevance of the audit report. Conversely, has the introduction of KAMs merely been another requirement that audit firms must adhere to as a tick-box exercise when issuing an audit report (Masdor & Shamsuddin, 2018)? The latter would not enhance the relevance of the audit report, as generic disclosures concerning areas of the audit where significant judgment was involved would not fulfill the purpose for why KAM paragraphs were introduced (ACCA, 2018). This is due to standard, generic or "boilerplate" language not having any added informational value for users (Segal, 2017). Further, the terms used in the KAM paragraphs will need to be assessed, as technical language would not be understandable to a reader of the audit report with an intermediate knowledge of financial accounting (Segal, 2019). Highly technical language would not be informationally valuable to users as the audit report would be less understandable (Asare & Wright, 2012; Jones, 1997).

1.3 Research question

The research question is aimed at attempting to measure the value relevance of KAMs. Value relevance is defined as the association between accounting information and security market values (Barth et al., 2000). As such, share price is a commonly used benchmark to determine value relevance (Chen, Chen, & Su, 2001; Oliveira, Rodrigues, & Craig, 2010; Plerou, Gopikrishnan, Gabaix, & Stanley, 2002; Wang, Alam, & Makar, 2005). Accordingly, the following research question was posed: To what extent is the KAM disclosure section value relevant for users?

1.4 Research purpose

The main purpose of this research is to bolster the existing literature regarding the disclosure of KAMs. The current body of literature mainly contains qualitative studies focused on KAMs (Bédard, Gonthier-Besacier, & Schatt, 2014; Segal, 2017, 2019; Sirois, Bédard, & Bera, 2018). The researcher set out to approach KAMs through a quantitative lens by assessing the value relevance of KAMs, as measured by the market to book ratio (Fama & French, 1992; Pontiff & Schall, 1998). The number of KAMs and the category of KAMs contained within the audit report were evaluated for value relevance. Furthermore, the researcher attempted to investigate the KAM itself to determine how the nature and content of the KAM may have influenced users' reactions.

As ISA 701 is a relatively new mandated disclosure for the audit report, the relevance of KAM disclosures was investigated to assess whether the section adds informational value to users. The KAM section in the audit report has only recently been introduced, therefore providing a rich area in which to conduct research.

1.5 Significance of the study

The KAM disclosure paragraphs are the most significant enhancement of audit reporting in recent years (Reintjes, 2015a; Segal, 2019). There is a need to assess whether the introduction of KAMs within a South African context is having the desired effect. The mandatory implementation of KAMs for listed clients was for entities with financial years ending on or after 15 December 2016 and is therefore a relatively new area for research to be conducted (IAASB, 2015c). KAMs are designed to showcase relevant information to users in areas where the auditor spent a large amount of time auditing transactions which required significant judgment (IAASB, 2015c). The implementation of KAMs in the audit report represents a significant change in auditing practices (IAASB, 2015a; Segal, 2019). The IAASB intends to undertake a post-implementation review of ISA 701 (2015c), therefore the current study may provide added information regarding whether users find KAM disclosures value relevant.

As KAMs are disclosures concerned with the most significant issues encountered during the audit, the illustration of these matters also enhances the quality of the audit. Recently, the auditing profession has been criticised in light of audit failures in South Africa involving, among others, Steinhoff and VBS mutual bank (Niselow, 2018; Rossouw & Styan, 2019; Ziady, 2018). Mechanisms illustrating how the audit was conducted are of importance in South Africa at present due to the increased desire for transparency. Research into the field of KAMs is significant in that it assesses whether audit quality is enhanced by the added disclosures, and therefore substantiates whether the disclosures are relevant from the perspective of the users of the audit report.

1.6 Assumptions, limitations and delimitations of the study

1.6.1 Assumptions

A common assumption used in the context of value relevance studies is that the market incorporates all relevant data into the share price of a company. This phenomenon is derived from the efficient market hypothesis (Malkiel, 2003; Malkiel & Fama, 1970). The efficiency of the main South African stock exchange, the Johannesburg Stock Exchange (JSE), has been established as weak-form efficient (High & Honikman, 1995). This indicates that the South African capital market does not incorporate all value relevant information immediately at the time the information is released. There exists a lag period before the information is considered

in the security value of a firm. It is assumed that users have incorporated the information relating to the KAM disclosures when making their investment decisions upon release of the audit report.

It was assumed that all users have access to the reports on the date that the audit report is released. This is a valid assumption as the audit reports are made available through electronic mediums which users will have access to at any point in time. It was also assumed that users incorporated all prior available information regarding a company appropriately when making investment decisions (FCA, 2014).

It was assumed that the audit firms who had provided the audit report and the KAM disclosure did so with the required level of competence, due care and skill. It was further assumed that all data within the sample had been subjected to audits which were conducted with the necessary adherence to ethical standards.

1.6.2 Limitations

KAMs must be disclosed for companies which are primarily listed on the JSE in terms of ISA 701 (IAASB, 2015c). The current research cannot be extrapolated to firms which do not have a primary listing on the JSE. This represents a limitation in the research, as the study may not be applicable to companies which have secondary listings on the JSE. KAMs are disclosed for foreign companies; however, there may be fundamentally different disclosure requirements for companies which are not mandated to adhere to ISA 701. This can possibly lead to comparability issues with the findings of this research in applying them to companies not primarily listed on the JSE.

South Africa is a developing economy (Luiz, 2002). Risks that the KAMs outline may be different to those KAMs relevant to developed economies such as France and the United Kingdom. The number and nature of KAMs raised may differ across different economies; as such the results in this study may not be suitable for developed economies, impacting the external validity of the study.

1.6.3 Delimitations

The research conducted was limited to companies listed on the JSE. KAMs are required to be disclosed for listed companies; however, unlisted companies may voluntarily disclose KAMs. The current research did not consider the value of KAM disclosures concerning unlisted companies.

1.7 Report structure

This report has been organised into 5 chapters. Chapter 1, the introduction, has already been outlined above, which has detailed the rationale behind the study and provided insight into the

research problem and how the research question was addressed. In Chapter 2, the literature review, the relevant research which was used to develop the hypothesis and contextualise the current study is presented. Chapter 3 is dedicated to the methodology of this study. In Chapter 4, the results are presented and discussed in the context of prior research on the topic of KAMs. In the final chapter, Chapter 5, the focus is on the conclusion and the conclusion of the research is highlighted in terms of the hypotheses developed. Possible areas for future research are also explored in this chapter.

CHAPTER 2: LITERATURE REVIEW

In the following chapter, a theoretical background will be provided for KAMs. Firstly, the auditing profession will be outlined, with a discussion regarding key issues surrounding auditing, namely agency theory, the purpose of financial reporting, the expectation gap, and the integrity of financial information disseminated to the market. Next, the auditing process will be highlighted to provide context to the introduction of KAMs in the audit report. Following from this, a detailed discussion concerning the genesis of KAMs, how KAMs are determined and their placement within the audit report will be given. Lastly, a broad discussion concerning value relevance will be provided.

2.1 The auditing profession

Auditing has been a persistent force over the centuries in the verification of financial information which a company portrays to the market. As early as 1346 A.D., verifications of stock, incomes, and expenses were conducted to ensure the veracity of financial information (Watts & Zimmerman, 1983). The formal need for an auditor to independently conduct an audit on the financial statements of a firm only arose in 1844, promulgated by the United Kingdom's first Companies Act (Watts & Zimmerman, 1983). Monitoring activities have been conducted for the past five centuries which reaffirms the Jensen and Meckling (1976) position that auditing is one of the monitoring activities which increases the value of the firm.

2.1.1 Agency theory

Agency theory outlines that the contributors of capital are usually distinct from the managers of a business, resulting in a separation between ownership and control (Florackis, 2008). Shareholders often have different risks and goals to those to whom they have delegated management of the business, resulting in possible conflicts of interests (Eisenhardt, 1989). Agents are not only expected to maintain the value of property entrusted to them, but continuously add value to property (Nwaobia, Luke, & Theophilus, 2016). Where the agent's personal interests take precedent over the obligation to comply with the agent-principal contract, the agency problem occurs (Jensen & Meckling, 1976). The agency problem arises when managers are incentivised to conduct business in a way which prejudices stock holders, by entering into unrefined investments which are high risk with low chances of return, fraudulent reporting, or theft of company assets (Bebchuk & Fried, 2003; Watts & Zimmerman, 1983). This conflict of interest arising between management and shareholders results in agency costs, as the enterprise incurs residual costs in ensuring that shareholder's and management's objectives align through the use of checks and balances (Jensen & Meckling, 1976).

A current example of the consequences of the agency problem in a South African context would be the accounting irregularities which occurred at Steinhoff (Niselow, 2018). The agents, being management, took part in fraudulent financial reporting which lead to the share price collapse of Steinhoff, resulting in the principals, being shareholders, losing significant value on their investment (Rossouw & Styan, 2019).

Jensen and Meckling (1976) illustrated that a method to mitigate the agency problem was to subject a firm to monitoring activities. In this way, auditing is seen as a critical line of defence against the agency problem. Agency costs associated with management engaging in opportunistic behaviour at the expense of shareholder wealth will reduce if a firm is subject to monitoring activities (Davis, Schoorman, & Donaldson, 1997). Auditors would only be effective in reducing agency costs if the auditor reported any instances of management acting against shareholders' interests (Watts & Zimmerman, 1983). Within the South African context, this would be the case as the auditor may be held personally liable for issuing an opinion negligently or fraudulently per s46 of the Auditing Professions Act.

With the introduction of added KAM disclosures enhancing the transparency of an audit, principals will gain further comfort that agents of the business are utilising the provided capital correctly. Disclosures surrounding how the audit was conducted to ensure that management has accounted for their actions correctly will reduce agency costs associated with information asymmetry (Morris, 1987). The auditor may therefore be seen as an effective deterrent to unscrupulous acts perpetrated by management that may cause a business to portray misleading information to the market (Watts & Zimmerman, 1983).

2.1.2 The purpose of financial reporting

Auditing has its focus on ensuring that the financial accounts of a business are portrayed faithfully and are free from material misstatements. As such, the purported purpose of financial accounting should be examined in order to further illustrate the value that an audit of financial information provides.

Financial reporting, or accounting, arose in the past as a means to record and prove transactions (Ravenscroft & Williams, 2009). Accounting may be traced back to as early as the first great civilisations, dating as far back as 5000 B.C. (Merino & Previts, 1998). From the early inception of the discipline, the main driving purpose of accounting has been the faithful representation of economic transactions and events. The true reflection of economic reality is the centre piece of financial reporting (Ravenscroft & Williams, 2009). Hines (1988) stated that "accounting is socially constructed and socially constructing", which means that accounting has an influence over society and, in turn, is shaped by society itself. This implies that accounting must have regard for the user-society as outlined by Nwaobia et al. (2016). The

user-society relates to the users of financial statements. By implication, the user-society also encompasses readers of the audit reports, as audit reports are released alongside financial statements, which lend assurance over the figures in the financial statements.

Financial accounting has developed and evolved throughout the years, both in complexity and purpose. Initially, financial accounting developed to record transactions. In recording transactions of the enterprise, management of the enterprise became accountable to those whom entrusted them to utilise capital effectively and transparently (Jensen & Meckling, 1976). The advent of financial accounting accordingly became synonymous with accountability (Ravenscroft & Williams, 2009). The root metaphor of accountability is one which intertwines with auditing, as the purpose of auditing is to ensure that stewards of the business remain accountable to those whom have provided capital to the enterprise by ensuring that transactions have been recorded faithfully (Davis et al., 1997; Nwaobia et al., 2016). The added disclosure requirements under ISA 701 (2015c) encapsulates the notion of accountability, as it is a method to publicly showcase how transactions which required most attention during the audit were audited. This is a method to hold the audit firm accountable by adding transparency to the audit work performed on significant transactions which users deem important in informing their decisions regarding the company (Mock, Turner, Gray, & Coram, 2009).

A shift has occurred in the intended nature of financial accounting, where the relevance of information disclosed has now overshadowed the importance of accurately recording historic transactions. Ravenscroft and Williams (2009) criticise the move from a root metaphor of accountability in financial accounting toward an information metaphor of information relevance as outlined by Beaver (1981). Where the root metaphor of accountability emphasised faithfully recording transactions, the information metaphor placed value on the usefulness and relevance of accounting information (Beaver, 1981; Ravenscroft & Williams, 2009). Collins, Maydew, and Weiss (1997) echo the sentiments of Ravenscroft and Williams (2009), as they outline how the professional community has given the impression that historical cost financial statements have lost their value relevance as the global economy has moved toward a technologically advanced service economy. This shift may also be seen in the implemented KAM audit reporting standard, ISA 701, where the audit of information is geared at providing relevant information to users to inform their decision regarding the company (IAASB, 2015c; Tušek & Ježovita, 2018). The IAASB (2015e) confirmed this by stating that the new audit standards, such as ISA 701, were intended to enhance communication between investors and the auditor, indicating a market-related objective in the development of ISA 701.

This shift may also be seen in ISA 700, which requires that a financial reporting framework must be geared at providing users with information which is relevant (IAASB, 2015b). The value relevance of auditing disclosures is an integral part of determining whether audit report improvements, such as ISA 701 (2015c), have achieved their intended purpose. The intended purpose of audit report improvements relates to conveying more relevant and valuable information that users may consider in informing their decisions.

The redirection of financial reporting, of which the auditing profession has followed, has led to users becoming inundated with an excess of financial and audit report information. In a recent South African study, Willow and Rocky (2018) found that the integrated reports, which are usually released alongside the financial statements, do not have any informational value. This is an example of how the excess of information is eroding the usefulness of the annual reports released. The excess of information widens the informational gap of users when attempting to read financial reports and understand the role of the auditor.

2.1.3 The expectation gap

The accounting profession has enjoyed an elevated status within South Africa. Indeed, the accounting profession in South Africa is ranked as one of the highest in the world in relation to audit reporting and accounting practices (Bowes et al., 2004; Maroun & Gowar, 2013; Segal, 2017). This is attributed to the intensive study programme and three year training articles that are required in order to reach the designation of a Chartered Accountant registered in South Africa (Kretzschmar et al., 2013; Segal, 2017).

The expectation gap outlines a fundamental misunderstanding between what the auditor is perceived to be responsible for versus what the actual responsibilities of an auditor involve per regulation and the ISAs (Monroe & Woodliff, 1993; Nwaobia et al., 2016; Sikka, Puxty, Willmott, & Cooper, 1998). A common misconception is that the auditor is tasked with providing assurance over whether any fraud has occurred at the audit client, or whether the audit client is a viable business to invest in due to its ability to continue to operate as a going concern (Hayes, Wallage, & Gortemaker, 2014; Humphrey, Moizer, & Turley, 1993; McInnes, 1994; Willmott, 1986).

The extent of technical language used within the audit report has been seen to widen the expectation gap between users and the auditor. In a study conducted by Asare and Wright (2012), it was found that users of the audit report had incorrect interpretations of technical auditing jargon. This indicates that there are fundamental gaps in understanding between the responsibilities of the auditor and what audit report information is intended to convey to the market (Asare & Wright, 2012). This confirms the position of Jones (1997) who showcases

how information value is lost when highly technical language is used in the report, making it less understandable.

The expectation gap links to the anticipation of the market regarding what information the auditor is expected to convey to the users. The KAM section in the audit report has been developed in order to provide users with useful information regarding disclosures around pertinent aspects of the audit (Reintjes, 2015a). With the introduction of the KAM section, the expectation gap may be reduced as more information is disclosed regarding the actual operations of an audit, which enhances the transparency of the audit and highlights the role of the auditor (Nwaobia et al., 2016; Sirois et al., 2018). Sirois et al. (2018) found that users' attention was diverted to KAM paragraphs, and that the users used the information contained in the KAM paragraphs to assess the financial statements. This illustrates the benefit of the KAM paragraphs in directing users' attention to certain aspects of the audit and, indirectly, on the auditor's role and responsibilities. This was reiterated by standard-setters who, after considering stakeholder comments, concluded that restructuring the audit report and including a KAM section was an avenue which could reduce the expectation gap (Sneller, Bode, & Klerkx, 2017).

2.1.4 The integrity of financial data

The auditing profession is of significant importance to the world's financial markets. This is due to the auditing profession providing assurance regarding whether the financial data distributed by firms is presented fairly, accurately, and contains no material errors or omissions (IAASB, 2009a). This allows the financial market to operate efficiently, as without the audit of financial information, confidence could not be placed on financial figures as the data could not be relied upon (Danescu & Spatacean, 2018; Masdor & Shamsuddin, 2018). This principle is echoed by Nwaobia et al. (2016), where it was stated that auditing enhances the public perception of financial statements. This was termed lending credibility theory, as investors, government, creditors and other important users make judgments based on audited financial statements. The auditing profession is seen to have the ability to lend credibility to the financial data portrayed by management in this regard (Nwachukwu, Ogundiwin, & Nwaobia, 2015). Added transparency surrounding the nature of the audit provided by ISA 701 will enhance the credibility of the financial statements.

2.2 The auditing process

2.2.1 Risk assessment

An audit of financial statements is mandated to comply with the ISAs for companies primarily listed on the JSE. An audit conducted in terms of the ISAs gives reasonable assurance that the financial statements of the client are free from material misstatements whether due to fraud

or error (IAASB, 2009a). Reasonable assurance is gained through sufficient and appropriate audit evidence being obtained through audit procedures conducted over the client's transactions and balances (IAASB, 2009c).

Transactions and balances are selected for testing via a sampling method based on the risk of the transactions or balances (IAASB, 2009b). Where a transaction or balance contains more risk that it has been misstated, the procedures conducted over that transaction or balance will be adapted to ensure more detailed procedures are performed. Transactions or balances which contain material risks of misstatement will attract a detailed degree of testing, which is encapsulated in the risk-based approach of auditing (IAASB, 2013).

The risk-based approach of auditing has been the predominantly used method when conducting an audit. The risk-based approach allows the auditor to focus attention and resources to areas which are likely to contain more risks and therefore are probable to contain more instances of misstatements (IAASB, 2009b). Although multiple other models regarding the selection and testing of transactions and balances have been proposed, such as the business risk model suggested by Curtis and Turley (2007), the risk-based approach to auditing remains the preferred methodology when conducting an audit (IAASB, 2009b).

KAMs link toward the risk assessment of a client (IAASB, 2015c). KAMs are captured within the risk-based method of auditing as areas with more risk require added time and resources to ensure that the transaction or balance has been recorded correctly. Matters which contain more judgment inherently contain more risk, and will likely be areas which the auditor will direct more resources to (IAASB, 2009b, 2013). KAMs, by their nature, are material transactions which occurred during the financial year which require a significant level of judgment (IAASB, 2015c). These areas will therefore invariably be afforded added resources during the audit (Weirich & Reinstein, 2014). The disclosures concerning KAMs would centre on the riskier areas of the client, where these areas are subject to estimation and judgment. Consequentially, the risk-based approach informs the KAMs that may be disclosed under the KAM section in the audit report. The higher amount of KAMs disclosed in the audit report illustrates that there is more risk that the financial statements of the entity may be materially misstated (IAASB, 2013, 2015c). If there is a higher probability that the financial statements of a company contain material misstatements possibly overlooked by the auditor due to more judgment being involved, users' decisions over whether to invest in that entity may be affected. This is due to the possibility that information that users will use to base their investment decisions on will be less credible (Hirst, Koonce, & Simko, 1995; King, Pownall, & Waymire, 1990; Maines, 1990). The number of KAMs raised in the audit report therefore has a direct link to the assessed risk of the entity.

2.2.2 The audit opinion

After audit evidence has been gathered, the auditor, having complied with the ISAs, is able to issue an audit opinion on whether the financial statements are fairly presented in terms of their financial reporting framework (IAASB, 2015b). An audit report can either be a modified or an unmodified report. An unmodified report contains an unqualified opinion, whereas a modified report indicates that an opinion has been qualified or given as adverse. For context, a qualified opinion reflects that there are material misstatements within the financial statements but which are not pervasive, whereas an adverse opinion indicates that the financial statements have pervasive material misstatements (IAASB, 2015b). The type of opinion issued informs the audit report. For example, if a qualified or adverse opinion is to be issued, a modified audit report will be generated as extra paragraphs explaining the basis for the qualified opinion must be included (IAASB, 2015b).

The audit opinion is seen to be a valuable aspect of the audit report (Mock et al., 2009). However, the audit opinion has garnered mixed views regarding its informational value, and therefore may no longer be conveying valuable information. In an effort to enhance the informational value of the audit report, the KAM section was introduced (IAASB, 2015e).

2.3 Key audit matters

2.3.1 The genesis of key audit matters

Audit report improvements will have the most salient impact if the changes result in enhanced reliability, additional relevant disclosures, and increased transparency of information contained within the report (Botez, 2017; Cordoş & Fülöp, 2015; Sneller et al., 2017). ISA 701 was developed with these principles in mind, with the aim of improving audit quality and reducing the expectation gap (IAASB, 2015e; Nwaobia et al., 2016).

In terms of ISA 701, KAMs are those matters, which in the auditor's professional judgment, were most significant in the audit of the client's financial statements (Bédard et al., 2014; IAASB, 2015c). KAMs are matters which have been selected from issues communicated to those charged with governance to be disclosed in the audit report (IAASB, 2015c; Reintjes, 2015a). Audits of public interest entities and listed entities must disclose KAMs found during the audit. Entities within the public sector may be required to disclose KAMs, while unlisted entities may voluntarily request that KAMs be disclosed (IAASB, 2015c; Reintjes, 2015a).

The objective of disclosing KAMs was to enhance the relevance of the audit report (IAASB, 2015e; Reintjes, 2015a). The proposal for added disclosures came after it was found that users' perceptions of audit report quality had declined over time (Cordoş & Fülöp, 2015). Carcello (2012) outlined that the audit report had limited informational content beyond the audit opinion issued to investors. Standard-setters referenced publicised audit failures, such

as Enron and Worldcom2 as well as the 2008 financial crisis, when providing the rationale for incorporating KAM paragraphs in the audit report (Masdor & Shamsuddin, 2018; Nwaobia et al., 2016). Such events have occurred within the South African auditing environment with the highly publicised audit failures relating to Steinhoff, VBS mutual bank, African Bank, and more recently Tongaat Hulett (De Villiers, 2019; Niselow, 2018; Rossouw & Styan, 2019; Ziady, 2018). Indeed, these events illustrate the need to provide additional insight into the financial statements of a company, a sentiment echoed by the chairman of the IAASB, Arnold Schilder (Masdor & Shamsuddin, 2018), who stated that:

> The global financial crisis also has spurred users', in particular institutional investors and financial analysts, to want to know more about individual audits and to gain further insights into the audited entity and its financial statements. And while the auditor's opinion is valued, many perceive that the auditor's report could be more informative.

KAMs were developed as a response to investors' and other users' request to make the audit report more entity specific as well as provide more relevant information to users through showcasing the areas of significant risk in the client (Masdor & Shamsuddin, 2018; Reintjes, 2015a). By doing so, the audit report is improved by becoming more entity specific and allows the audit report to move away from generic or "boilerplate" communication which users feel is irrelevant (Reintjes, 2015b; Segal, 2017). Through this method, significant risks which were audited will be conveyed to users, as areas of significant risk in the client will in the majority of cases be disclosed as KAMs (IAASB, 2013, 2015c; Nwaobia et al., 2016). This is in line with the objective of improving audit reporting through enhancing transparency and increasing the reliability of the report while conveying relevant information to users (Botez, 2017; Cordoş & Fülöp, 2015; Reintjes, 2015a; Sneller et al., 2017). KAM disclosures showcase their relevance in illustrating audit quality by outlining how certain risky areas were addressed to obtain sufficient and appropriate audit evidence that the transaction or balance was not materially misstated (Masdor & Shamsuddin, 2018). KAMs also have value in bridging the communication gap present in audit reporting, and as a result narrowing the expectation gap present in the auditing environment (Tušek & Ježovita, 2018). The communication gap present in auditing has a detrimental effect on users' understanding of the statutory responsibilities of the auditor. This was the finding in a study conducted by Porter, Ó hÓgartaigh, and Baskerville (2012) who illustrated that the content of the audit report does not give reasonably knowledgeable users a sufficient understanding of the nature of the auditing process, and the responsibilities of the auditor.

In a study conducted by Christensen, Glover, and Wolfe (2014), it was found that investors who received a critical audit matter (CAM) report (the equivalent to KAMs in America) were likely to change their investment decisions in light of the CAM information. This indicates that the intended objective of added transparency would be relevant to users, thereby fulfilling the objective of the added disclosures paragraphs provided by ISA 701. This further indicates that there is a link between audit report disclosures and its ability to inform users' decisions in the capital market. This reiterates the IAASB's commentary on KAMs, which stated that auditors possess a great deal of information concerning the entity, and the added disclosure would convey more valuable information to users in aiding them to make decisions (IAASB, 2011). This indicates that the higher the amount of information concerning the audit process, the more relevant it may be to users (Christensen et al., 2014; Segal, 2019). Furthermore, the chairman of the IAASB specifically referenced institutional investors and financial analysts when detailing which users are requesting more information regarding the audit (Masdor & Shamsuddin, 2018). This explicitly showcases the link between the newly implemented KAM section of the audit report and the capital market.

2.3.2 Determination of key audit matters

The risk-based model of auditing informs the KAMs disclosed in the audit report, as riskier areas will be directed more resources and time during the audit. KAMs are selected from issues which have been communicated to those charged with governance (IAASB, 2015c). The KAMs are those matters which required significant attention by the audit team, and were commonly areas of material risk in the client (IAASB, 2015c; Reintjes, 2015a). KAMs should be communicated consistently, however, due to the risk-based model of auditing; the audit approach used may be different across the auditing firms in relation to similar entities. In light of this, the reporting of KAMs may differ slightly from different audit firms (Reintjes, 2015b). There is no requirement in place which dictates that a set amount of KAMs must be disclosed per client. This determination is left to the audit firm. However, audits of listed entities with complex business structures would likely result in more than one KAM being disclosed (IAASB, 2016; Reintjes, 2015b). Areas which are frequently illustrated as KAMs relate to accounts which have estimation uncertainty or are complex in their calculation and require professional judgment. Common examples of such accounts include goodwill impairments, fair value measurements, and business combinations (Masdor & Shamsuddin, 2018). Below is a diagrammatic representation of how KAMs are determined during an audit.

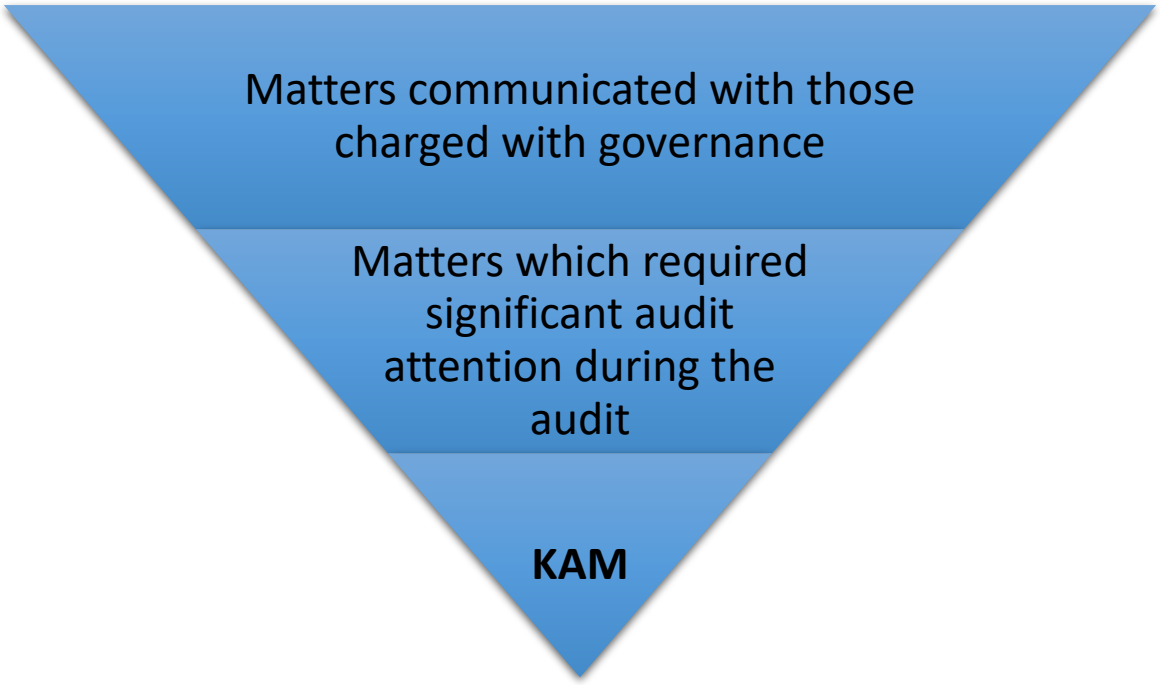


Figure 1. Determination of key audit matters

2.3.3 The audit report

There must be a separate section within the audit report which details the KAMs engaged during the audit, and a brief overview of the procedures conducted in order to address each KAM encountered (IAASB, 2015c; Reintjes, 2015a). However, if the company in question has a going concern uncertainty, such an event must be dealt with separately under the material uncertainty relating to the going concern of the entity section in the audit report in accordance with ISA 570 (IAASB, 2009e). Going concern are by their nature KAMs, and where there is no material uncertainty that casts doubt on the entities ability to continue as going concern, and sufficient procedures were carried out on the going concern of the entity, it may be included as a KAM (IAASB, 2009e, 2015c).

The intention behind the separate disclosure was to draw attention to the paragraphs within the audit report. In a study conducted by Sirois et al. (2018), it was found that readers of the audit report focussed their attention on the KAM paragraphs as they had been separately disclosed, illustrating some benefit of the separate disclosure. Furthermore, in countries such as Australia, Brazil, and Hong Kong, information conveyed by KAMs were found to be useful for investors, as well as enhancing audit quality as a whole (Masdor & Shamsuddin, 2018). Therefore, readers of the audit report consider the KAM section as valuable and relevant information when assessing the entities audit report.

2.4 Value relevance

Value relevance is defined as the association between accounting information and a firm's securities market value (Barth et al., 2000). Value relevant methodologies assume that the function of accounting information is to capture and reflect economic value, as represented by the share price, or market value, of a company (Hellström, 2006; Holthausen & Watts, 2001). This principle is echoed in the works of Ravenscroft and Williams (2009) who believe that financial accounting's purpose has shifted away from portraying historic amounts toward conveying relevant information for users encapsulated in fair value accounting. Accounting measurements which are most relevant are based on market values, and contain the most useful information for users (Whittington, 2008; Zhang & Andrew, 2014). As such, the value relevance of financial accounting information has increased, as outlined by a study conducted by Ali and Hwang (2000). This shift has also been seen in the audit reporting space, with the IAASB introducing new ISA's, such as ISA 701, with the aim of increasing transparency of the auditing process and thereby providing users with more relevant and useful information (IAASB, 2015e; Tušek & Ježovita, 2018).

Financial information is value relevant, however, financial information does not alone account for the market value of a firm. Accordingly, additional non-financial information is a key determinant in valuing the equity value of an enterprise (Lev & Sougiannis, 1996; Ohlson, 1995). In a study conducted by Lev and Amir (1996) certain non-financial indicators were value relevant to investors, such as the growth of a firm and market penetration. ISA 701 was established in order to provide users with more valuable information and is a piece of non-financial information. In a study conducted by Christensen et al. (2014), the value relevance of CAMs, the equivalent to KAMs in America, was assessed. The findings of the study were that investors who received a CAM report changed their investment decision compared to investors who received a standard audit report excluding CAMs. This illustrates that CAMs, and therefore KAMs, would likely be regarded by users as value relevant non-financial information.

2.4.1 The efficient market hypothesis

The efficient market, as outlined by Malkiel and Fama (1970), outlines that stock prices efficiently incorporated information circulating in the capital market. It was believed that when information was conveyed to the market, it spread rapidly and was priced into the securities of a company without delay (Malkiel, 2003). The implications of the efficient market hypothesis were that, as information is incorporated instantaneously into a share price, an investor was unable to locate undervalued shares and achieve an arbitrage profit (Fama, 1965; Malkiel & Fama, 1970).

Flowing from the efficient market hypothesis were the classifications of the markets in question. Three categories were established: strong form capital markets are assumed to incorporate all available information possible, including information which is not necessarily available to the public yet. Semi-strong capital markets incorporate publicly available information, and thus allow for the share prices to reflect the available information. Lastly, a weak-form capital market is seen to have no memory, that is to say, share prices move independently from previous share price movements (Malkiel & Fama, 1970).

The JSE has been seen to be a weak-form efficient capital market, as such information which is value relevant may be incorporated into the share price of a company within a certain time period (High & Honikman, 1995; Mlambo & Biekpe, 2007). Multiple studies have assessed the value relevance of information as measured by share price using the JSE (Baboukardos & Rimmel, 2016; de Klerk & de Villiers, 2012; Marcia, Maroun, & Callaghan, 2015; Willows & Rockey, 2018; Wolmarans & Sartorius, 2009). Evidence from the JSE suggests that share prices are more sensitive to negative information than favourable information (Bhana, 1995). This may indicate that the value relevance of KAMs may not be reflected in the market value of a firm if the information conveyed by the KAM is seen as favourable by users.

2.4.2 Measuring value relevance

In developing the new ISA reporting standards such as ISA 701, the chairman of the IAASB made specific reference to institutional investors and financial analysts (Masdor & Shamsuddin, 2018). This highlights that the intended aim of ISA 701 was to provide participants in the capital market with more transparency regarding the audit of financial information (Masdor & Shamsuddin, 2018). Value relevant information, as determined by the capital market, would be reflected in the market value of the firm (Barth et al., 2000; Hellström, 2006).

The share price of a company is a representation of investors' demand to invest in that company, as the share price will increase in value if more market participants demand the share (Plerou et al., 2002). Accordingly, share price is seen as a signal to the market of the value of a company. The market value of a firm is a product of the number of authorised issued shares in circulation and share price. The market value of a firm thus showcases the current value of a firm as determined by market participants (MacKinlay, 1997). This market value, as determined by investors, often deviates from the book value of a firm. The difference between the market value and book value of a firm represents the premium that investors value the company at over and above the book equity value of the company. This phenomenon is encapsulated in the market to book ratio of the firm in question (Sáenz, 2005). The market to book ratio can be seen as a measure of value relevance, as it showcases the extent to which

investors are valuing the firm's securities over the book value of a firm's equity considering information concerning the company (Barth et al., 2000). The premium which investors are willing to pay is due to valuable financial and non-financial information concerning the company in question (Ohlson, 1995). The Ohlson (1995) valuation model incorporates the market to book ratio when assessing the value relevance of information. The model attempts to portray the relationship between the book value of equity to the market value of a firm's equity. The Ohlson (1995) model is commonly used in value relevance research (Aboody, Barth, & Kasznik, 1999; Barth, Beaver, & Landsman, 1992; Burgstahler & Dichev, 1997; De Klerk & De Villiers, 2012; Marcia et al., 2015). The market to book ratio, or a modification thereof, has been used to establish value relevance of non-financial information in previous studies concerning corporate social reporting (De Klerk & De Villiers, 2012; Marcia et al., 2015).

The market to book ratio is a function of the market capitalisation of a firm over the book value of equity of the firm (Correia, Flynn, Uliana, Wormald, & Dillon, 2015). The market capitalisation of a firm is the current market value of the firm's total securities. Accordingly, both financial and non-financial information which affects share price must be considered in establishing why users are paying a premium for a firm's equity. The areas considered to encapsulate value relevant information included KAM disclosures, the integrated report, firm size, dividend yield, growth in attributable earnings, growth in cash flows from operations, the audit opinion, accounting restatements, and firm sector. These areas of value relevant information will be further expanded on in the following sections.



Figure 2. Value relevant information

2.4.2.1 Key audit matter disclosures

As has been established in the existing literature, KAM disclosures are aimed at providing users with relevant information by enhancing the transparency of the audit process (IAASB, 2015e; Reintjes, 2015a). The extent to which this objective may have been achieved can be assessed through the number of KAMs and the category of KAMs disclosed as non-financial information. If the objective of ISA 701 has been achieved, then, in light of prior literature concerning valuable non-financial information, KAMs would influence the market value of a firm (IAASB, 2015e; Low & Siesfeld, 1998; Masdor & Shamsuddin, 2018; Riley Jr, Pearson, & Trompeter, 2003; Wyatt, 2008).

The number of KAMs disclosed link toward the risk assessment of the client, as has been discussed in Section 2.2.1. The higher number of KAMs disclosed is an indication of the level

of complexity in the audit of the client. This is an indication of the amount of risk in the client, However, the number of KAMs raised is also an indicator of the added transparency given to the capital market concerning the audit of the client (IAASB, 2015e; Masdor & Shamsuddin, 2018). Added transparency is aimed at giving users more value relevant information which they may use to base their investing decision upon, and therefore may influence the market value of a firm.

The nature of the KAMs disclosed may also be seen as value relevant to users. Certain financial performance measures are viewed as relevant when considering investing in a firm. Barton, Hansen, and Pownall (2010) found that investors viewed cash flows from operations as pivotal when informing their investing decisions. In a study conducted by Collins et al. (1997), it was found that investors considered earnings as value relevant financial information for investment decisions. This perspective is shared by multiple studies illustrating that earnings or profitability is seen as value relevant (Bernard, 1989; Bowen, Burgstahler, & Daley, 1986; Dechow, 1994; Livnat & Zarowin, 1990; Rayburn, 1986; Sloan, 1996; Wilson, 1986). KAMs offer enhanced transparency as to how faithfully management has recorded these vital financial line items. Accordingly, what the KAM disclosure relates to may be value relevant to users. The categories of the KAM disclosures are illustrated in more detail in Section 3.3.3.2.2 of the methodology chapter.

2.4.2.2 Integrated report

The integrated report is a disclosure of sustainability performance, corporate social responsibility and other non-financial information. Per the JSE listing requirements, a firm is mandated to release an integrated report if it is a listed entity. The value relevance of the integrated report information has been a highly researched area in South Africa (Baboukardos & Rimmel, 2016; de Klerk & de Villiers, 2012; Marcia et al., 2015; Willows & Rockey, 2018).

Willows and Rockey (2018) investigated whether any significant cumulative average abnormal returns were observed before and after the release of companies financial results and integrated report. In the context of the JSE, the study conducted by Willows and Rockey (2018) found that there were no significant cumulative average abnormal returns associated with the release of the integrated report, indicating that the integrated report was not value relevant.

In a study conducted by Marcia, Maroun, and Callaghan (2015), the value relevance of corporate responsibility reporting, as contained in the integrated report, was assessed. The study sampled 82 JSE listed companies, and found that there was no significant association between a company's share price and their level of corporate social responsibility (Marcia et al., 2015).

In contrast to Willows and Rockey (2018) and Marcia, Maroun, and Callaghan (2015), De Klerk and De Villiers (2012) found that share prices of companies with higher levels of corporate social responsibility are likely to be higher. The study in question utilised a modified Ohlson model to examine the value relevance of non-financial information relating to corporate social responsibility reporting of companies listed on the JSE (De Klerk & De Villiers, 2012).

2.4.2.3 Firm size

Firm size has been seen as a financial measure which influences share price and ultimately the market value of a firm (Collins et al., 1997). In a study conducted by Beneish, Billings, and Hodder (2008), the study examined firms which made audit report disclosures concerning internal controls in terms of the Section 404 of the Sarbanes-Oxley (SOX) Act. Firms with similar sizes were present in the study to control for any changes in share price attributable to the firm size of the companies in the sample. This indicates that firm size has an influence over share price, and consequently the market value of a firm, and therefore is seen as value relevant information to users (Beneish et al., 2008).

In a similar study conducted by Singer and You (2011), the effect of Section 404 of the SOX Act on the reliability of reported earnings, leading to increased disclosure surrounding the audit of financial information, was assessed for value relevance. The findings illustrated that added transparency surrounding the disclosure of financial information is value relevant. Within the study, firm size was specifically controlled because firm size is seen as a proxy for future growth which, in turn, is seen as value relevant to users (Singer & You, 2011).

2.4.2.4 Dividend yield

Dividend yield represents financial information regarding the dividend paid out by a company. Dividend pay-out is an influential aspect on the market value of a firm as it is seen to affect share price (Ross, 1977). As the context of the current study is based on the JSE, the effect of dividend policy needed to be considered. Research conducted by Bhana (1991) found that emerging markets are dividend driven, as the cessation of dividends on the JSE resulted in a significant reaction. This substantiates the informational content of dividends, confirming that they are value relevant to users. This ratifies the signalling hypothesis of dividends as outlined by Ross (1977) which theorised that dividend payments represent returns for invested capital and is therefore valuable for users.

The findings of Liu (2003) found that significant negative abnormal stock returns for up to 5 years are associated with dividend omissions or reductions in emerging markets, further illustrating the informational power of dividend yields of companies listed on the JSE. This also highlighted Bhana's (1995) conclusion that shares listed on the JSE are more sensitive to negative information.

2.4.2.5 Growth in attributable earnings

Changes in attributable earnings or profitability is seen to influence the market value of a company, as it is seen as value relevant information for users (Collins et al., 1997). In a study conducted by Collins et al. (1997), the value relevance of earnings and book values were investigated, with the findings illustrating that both earnings and book values are value relevant to users. This conclusion is replicated in the study conducted by Goodwin and Ahmed (2006) who investigated the value relevance of earnings for Australian firms. The findings of this study were that there is weak evidence that earnings has declined in value relevance, and therefore remain an important issue for the market value of a firm. This conclusion was replicated in a study conducted by Landsman and Maydew (2002).

The findings of a study conducted by Livnat and Zarowin (1990) were that earnings were an effective measure to evaluate a firm's performance. This represents that earnings are a piece of financial information which users deem to be value relevant information when making investing decisions.

Contrary to the findings of Collins et al. (1997) and Goodwin and Ahmed (2006), Amir and Lev (1996) argued that earnings and cash flows are no longer seen as value relevant when valuing companies which are in the cellular industry and other intangible asset heavy industries. This conclusion was replicated in a study conducted by Francis, Schipper, and Vincent (2002), which found that the value relevance of earnings had been declining, while book values had been increasing.

2.4.2.6 Growth in cash flows from operations

Cash flows are important in assessing a firm's liquidity. The more liquid a firm is the more valuable a firm is seen to be (Correia et al., 2015). In a study conducted by Charitou, Clubb, and Andreou (2000), 6662 firm year observations were investigated in assessing the value relevance of earnings and cash flows of firms. The findings of the study illustrated that cash flows are seen as value relevant information, being positively associated with security prices (Charitou et al., 2000). This finding was corroborated by Gee-Jung (2009) who assessed the value relevance of cash flows, earnings, and book values. In the study it was found that the value relevance of both book values and cash flows had increased throughout the study period (Gee-Jung, 2009). In a study conducted by Wilson (1986), it was found that cash flows have incremental informational content beyond earnings, indicating that cash flows portray value relevant information. This conclusion was further reiterated by Bowen, Burgstahler, and Daley (1987), Bowen et al. (1986) and Cheng, Chao-Shin, and Schaefer (1997), who reported that cash flows have additional informational value in addition to reported earnings. The above

literature corroborated the statements that cash flows remain a value relevant piece of financial information to users.

2.4.2.7 Audit opinion

The audit opinion has received mixed views in terms of its relevance to users. Gul (1990) investigated the influence of unqualified audit reports on share prices. The findings by Gul (1990) indicated that qualified audit opinions effected share prices negatively. Similar findings were illustrated by Firth (1978), where the research found that share price responded to different types of audit reports issued, therefore investor decisions were influenced by the type of audit opinion contained within the audit report. Chen, Su, and Zhao (2000) investigated the effect of modified audit opinions on share price during the period of 1995 to 1997 on the Shanghai Stock Exchange. The results of the study showed a significant negative association between modified audit opinions and cumulative abnormal returns.

Conversely, Ameen, Chan, and Guffey (1994) researched whether the share price of small scale companies were influenced by the type of audit opinion issued. The study found no market reaction to occur during the event period of the 177 qualified audit reports sampled during the period covering 1974 to 1988 in America. Martínez, Martínez, and Benau (2004) research was based on the Spanish capital markets, and was directed at investigating whether qualified audit reports have an effect on share prices, with no relationship being found. Moradi, Salehi, Rigi, and Moeinizade (2011) investigated the effect of qualified audit reports on share price for companies listed on the Tehran Stock Exchange and found no significant effect on share price.

Although the conclusions regarding the relevance of audit opinion are mixed, they remain a piece of non-financial information which may still be seen as having value relevance to users.

2.4.2.8 Accounting restatements

A financial statement restatement occurs if there has been an error or omission which must be corrected in order to be in compliance with the financial reporting framework (IASB, 2001). Rezee, Espahbodi, Espahbodi, and Espahbodi (2012) examined stock price reactions to SOX act Section 404 compliance, therefore assessing the value relevance of compliance with non-financial disclosures. Within the study, prior year restatements were controlled for as there were seen to be an indicator of a lack of financial controls over the reporting process. As such, prior year restatements were seen as value relevant as a lack of controls over the financial reporting process indicated to the market that their decisions regarding the entity may be based on incorrect or untrustworthy data (Rezee et al., 2012). The integrity of data has been seen as an important piece of value relevant information when considering investing decisions regarding a company (Danescu & Spatacean, 2018).

2.4.2.9 Firm sector

Firm sector is an important aspect in the evaluation of value relevance of financial or non-financial information. Schwert (1981) outlines this principle, where security returns for firms in the same industry are associated as firms will react similarly to unanticipated events. Accordingly, value relevance of financial and non-financial information may be different depending on the industry that the company is in.

CHAPTER 3: METHODOLOGY

The methodology that the research employed was quantitatively based, using a multiple regression analysis. The multiple regression was used to determine the effect of the number of KAMs and category of KAMs contained within the audit report on the market to book ratio of a firm. The hypotheses will first be outlined. Next, the population and sample will be illustrated. Following on this discussion, an overview of the regression and a description of each of the variables will be discussed. Lastly, the assumptions underpinning the multiple regression model will be outlined to showcase the robustness of the method.

3.1 Hypothesis development

The purpose of the study is to attempt to quantify and measure the value relevance of KAMs. Quantifying the value relevance of KAMs was done by using the market to book ratio as a proxy for value relevance. Considering the above literature, the following hypotheses were established in terms of the value relevance of KAMs.

Firstly, the number of KAMs disclosed in the audit report showcases relevant information, and thus will be value relevant for users:

Hypothesis 1: The number of KAMs disclosed is value relevant.

Secondly, the nature of the KAM disclosed signifies the type of relevant information added to the audit report, and will be value relevant for users:

Hypothesis 2: The category of KAMs disclosed is value relevant.

3.2 Population and sample

3.2.1 Population

ISA 701 (IAASB, 2015c) states that KAM disclosure is mandated for listed entities with financial year ends on or after 15 December 2016. Accordingly, the population of firms in the current study only consisted of JSE listed firms with year ends on or after 15 December 2016. This led to a population comprising of firms listed on the JSE with financial year ends between 2016 and 2019.

3.2.2 Sample

The sample of the study that was extracted from the population constituted a selected number of companies listed on the JSE. The sample size in this study comprised of 160 companies listed on the JSE. The companies with the highest market capitalisations were chosen to be included in the sample. The companies with the highest market capitalisations were chosen purposively as larger companies have inherently more complex operations, and therefore are likely to contain more KAMs (Reintjes, 2015b). Firms which were not primarily listed on the

JSE were excluded from the sample, as these firms are not mandated to comply with all JSE listing requirements. This includes the requirement to comply with the ISAs; and to control for any variation in the disclosure of KAMs as set out in ISA 701 (IAASB, 2015c), firms with secondary listings on the JSE were excluded from the sample. Firms publicly disclose whether they are primarily listed on the JSE or not within their annual financial statements. If a company which was ranked for selection due to its market capitalisation was not primarily listed on the JSE, the company was disregarded and the next company on the listing was considered. A company which was ranked for selection was assessed for its data availability. If a company did not have data for the analysis available, it was purposively excluded from the analysis.

According to Leedy and Ormrod (2013), if a study has more than 100 observations, then a sample of the population may reasonably be extrapolated to the population. Furthermore, the amount of companies which comprised the sample allowed for inferential statistics to be computed and a p-value to be determined (Cameron & Windmeijer, 1997). Of the total sample size of 160 primarily listed JSE companies, 61 companies had a 2017 financial year end and 99 companies had a 2018 financial year end. Of the companies, 58 companies had data pertaining to two different time periods, being 2017 and 2018. All data points collected were used in the regression model.

3.3 Overview of method and data analysis

3.3.1 Data

The current research employed a positivist approach, by way of a multiple regression, to test the hypotheses. The data that was used in the study was collected exclusively from the IRESS database. The IRESS database is a data source which contains all relevant documents, such as financial statements and audit reports. The database also provides financial metrics which were used in the study, such as changes in cash flows from operations and attributable earnings. The IRESS database is a robust stream of data which enhances the validity and reliability of the study, as the data extracted is seen to be accurate (Chan & Faff, 2003; Fan & Palaniswami, 2001).

3.3.2 Regression model

A regression model is a statistical technique which is designed to show the predictive relationship between one or more independent predictor variables and a dependent variable (Chatterjee, Hadi, & Price, 2006). The equation of simple linear regression is shown below:

Equation 1: Simple Regression Model

$$\gamma_i = \beta_0 + \beta_i X_i + \varepsilon_i$$

Where γ_i is the dependent variable, β_0 is the constant term, ε_i is the error term, β_i is the beta coefficient, and X_i is the independent variable. As shown by Equation 1, a simple linear regression can only show the relationship between a dependent variable and one independent variable. As two independent variables were used in the current study, a simple linear regression could not be used.

A multiple regression incorporates numerous independent variables, or predictor variables, in a regression analysis (Draper, Smith, & Pownell, 1966). A multiple regression assesses the impact of multiple predictor variables on the dependent variable. The multiple regression model is shown below:

Equation 2: Multiple Regression Model

$$\gamma_i = \beta_0 + \beta_1 X_{1i} + \beta_2 X_{2i} + \ldots + \beta_k X_{ki} + \varepsilon_i$$

Where γ_i is the dependent variable, β_0 is the constant term, ε_i is the error term, β_k is the beta coefficient for independent variable k, and X_{ki} is independent variable k.

A multiple regression model was used to determine whether the number of KAMs and the category of the KAMs had explanatory power in determining the premium that investors pay for equity in a company, as measured by the market to book ratio. This was done by assessing how much of the variation in the market to book ratio is explained by the variation in number of KAMs raised, as well as the type of KAM raised, while controlling for the effects of certain variables. The significance of the independent variables were analysed by comparing their computed p-value to a confidence interval of 95%. All statistical procedures were carried out using the SPSS statistics package. The KAM regression model was defined as follows:

Equation 3: Key Audit Matter Regression Model

$$\frac{MV_{it}}{BV_{it-1}} = \beta_0 + \beta_1 KAM(N)_i + \sum_{n=2}^{17} \beta_n KAM(C)_{ni} + \beta_{18} IntegratedReport_i +$$

$$\beta_{19} AuditOpinion_i + \beta_{20} DividendYield_i + \beta_{21} \Delta CashFlows_i + \beta_{22} \Delta Earnings_i + \beta_{23} FirmSize_i$$

$$+ \beta_{24} Restatement_i + \sum_{n=25}^{34} \beta_n FirmSector_{ni} + \varepsilon_i$$

Table 1

Description of Variables

VARIABLE	DESCRIPTION

$\frac{MV_{it}}{BV_{it-1}}$	Represents the market to book ratio for company i.
β_0	Represents the regression constant.
β_i	Represents the standardised beta regression coefficient.
$KAM(N)_i$ $(KAMN)$	Represents the number of KAMs for company i.
$KAM(C)_i$	Represents the category of the KAM for company i.
$IntegratedReport_i$ (IR)	Represents whether company i released an integrated report.
$AuditOpinion_i$ (UO)	Represents whether company i received an unqualified audit opinion.
$DividendYield_i$ (DY)	Represents the dividend yield for company i.
$\Delta CashFlows_i$ $(CFOC)$	Represents the change in cash flows from operations for company i.
$\Delta Earnings_i$ (EC)	Represents the change in attributable earnings for company i.
$FirmSize_i$ (FS)	Represents the firm size of company i.
$Restatement_i$ (Res)	Represents whether company i had a restatement in their financial statements.
$FirmSector_i$	Represents the sector that company i is classified under as per the JSE sector categorisations.
ε_i	Represents the regression error term.

3.3.3 Research variables

3.3.3.1 Dependent variable

The dependent variable was established as the market to book ratio. As discussed previously, the market to book ratio is seen as the premium which investors are willing to pay for the securities of a firm over the book value of equity (Correia et al., 2015). The dependent variable is defined in the current research as the market value of a firm, as determined as a product of number of shares and share price, over the opening balance of total shareholders' equity, in line with other value relevance studies (de Klerk & de Villiers, 2012; Marcia et al., 2015). The market values of the companies sampled in the population were extracted from the IRESS database, along with the opening balance equity figures. Where the opening balance equity

for firms were denominated in foreign currency, the spot rate at the beginning of the company's financial year was used to convert amounts to local currency.

3.3.3.2 Independent variables

The independent variables in the current study related to the number of KAMs raised in the audit report, and the category of the KAM raised.

3.3.3.2.1 Number of key audit matters

For each company in the sample the audit report of the company was extracted from the IRESS database. After the audit report was obtained, the KAM section of the audit report was inspected for the number of separate KAMs raised in the report. No audit report in the sample of companies had been withdrawn, indicating that the KAM sections were not altered after the audit report was released which enhances the validity of the KAM disclosures observed.

3.3.3.2.2 Category of key audit matters

The KAMs disclosed were divided into 16 separate categories which will be discussed in the following section. A brief overview of the category of KAMs will be presented in Table 2 following this discussion.

The valuation of financial assets related to KAMs disclosed concerning complex financial asset valuations, such as accounts receivable, loan receivables, and other debt instruments. Many KAM sections dealt with the expected credit loss allowances which must be provided for under the International Financial Reporting Standard (IFRS) 9 (IASB, 2014a). Impairment of financial assets was a major defining factor in the complexity of valuing financial assets from the KAM section of the audit report.

The valuation of financial instruments concerned complex valuations of equity shares, investment in associates, and joint ventures, as well as the initial implementation of IFRS 9. This KAM category differed from the valuation of financial assets, in that this category was concerned with KAMs surrounding the accounting for equity shares. Many of the KAMs in this category were in valuing investments in associates and joint ventures. Providing for impairment on such investments were commonly disclosed KAMs. Another commonly disclosed KAM was the new implementation of IFRS 9, and in assessing whether management had faithfully reported the measurement of the financial instruments held by the company in accordance with IFRS 9.

The valuation of intangible assets related largely to goodwill calculations and impairments. International Accounting Standard (IAS) 38 states that goodwill and intangible assets with indefinite useful lives must be tested annually for impairment irrespective of an indicator of impairment (IASB, 1998). Estimates that were used in assessing goodwill impairments

consistently arose as KAMs through many company audit reports. Another common KAM in this category was the determination of the useful life of the company's intangible assets such as software and patents.

The valuation of liabilities primarily related to the measurement of provisions. These provisions related to predicted future expenditure on employee training, rehabilitation costs, future predicted litigation costs, and post-retirement benefits.

The valuation of non-current assets related to the valuation of land and buildings. Investment property may be measured on either the fair value basis or at historic cost (IASB, 2000). Many companies chose to measure their investment properties on the fair value basis, leading to KAM disclosures on the valuation techniques used. The measurement of investment property at fair value was the most commonly disclosed KAM in this category. Other KAM disclosures within this category related to the determination of residual values and useful lives of non-current assets and impairments of non-current assets.

The valuation of inventory included the measurement of possibly obsolete stock. Raising provisions for inventory was a commonly disclosed KAM within this category. The inventory provisioning was for the anticipated theft, damage or inappropriate quality of inventory received by the company. Another KAM within this category related to the accuracy of measurement of stock.

The valuation of insurance contracts was a commonly disclosed KAM. This was mainly due to the complexity surrounding the actuarial assumptions and calculations inherent in these contracts.

Share based payments was a disclosure relating to the recognition of complex share-based payment schemes. Many of these schemes related to broad-based black economic empowerment (BBBEE) schemes. Many of these transactions involve complicated accounting and a high degree of estimation and judgment, and therefore were raised as KAMs.

Taxation related to income and deferred tax calculations. The calculation and recovery of deferred tax assets were common KAM disclosures. Other KAM disclosures relating to taxation involved uncertain tax positions associated with future estimated tax liabilities. Foreign tax computations were also seen as KAMs within this category.

Related party transactions were disclosures concerning intercompany and intergroup transactions. Many of these KAMs related to complex structured transactions between shareholders or subsidiaries. As transactions with related parties is considered a significant risk as per ISA 315 (IAASB, 2013), which requires specific attention during the audit in terms

of ISA 550 (IAASB, 2009d), more audit attention would be directed to these areas. If the transactions in question were complicated, they would by extension be considered KAMs.

Consolidation KAMs related to the accounting implications on acquisition of separate business enterprises. As IFRS 3 requires the re-measurement of all the investees' assets and liabilities to market value, a significant amount of estimation is involved in consolidation accounting (IASB, 2008). Other KAM disclosures within this category related to the accounting for deconsolidating businesses from the group.

The discontinued operations KAM related primarily to separate business units in the company being classified as held for sale per IFRS 5. Under IFRS 5, once a business component has been classified as held for sale, its fair value must be determined per the measurement requirements outlined in IFRS 5 (IASB, 2004). This leads to significant estimation on management's part in estimating the fair value of the business unit, especially as there is usually no open market for such assets. Furthermore, the accounting under IFRS 5 in holding separate business units as discontinued operations is complex, leading to more audit attention being focused on these areas.

Supplier rebates referenced discounts that a company had been afforded by purchasing in bulk from their suppliers. Supplier rebates therefore illustrated a reduction in cost of purchases from suppliers. The accounting for such rebates was complex due to the estimation involved with the rebates the entity would receive, as well as the accounting involved with supplier rebates. The KAM associated with supplier rebates exclusively referred to the recognition of discounts received.

Going concern disclosures related to whether there was a material uncertainty that the business entity would not operate as a going concern in the foreseeable future. Many going concern KAMs involved inspecting management's assessments of going concern and the liquidity position of the enterprise.

The control environment KAM disclosures referred to new software implementations in the business. New system implementation leaves the enterprise vulnerable to cyber hacking and system processing issues. These were issues that were important during the audit in assessing whether the control environment, which the controls are based within, had been affected by the new system being implemented. Other KAM disclosures related to financial irregularities which occurred at the company. A company with an adequate control environment would not have instances of fraud and financial irregularities occurring.

The revenue KAM disclosure related to the recognition and measurement of revenue under IFRS 15. IFRS 15 is a complex standard to apply to the recognition and measurement of revenue, and as such was treated as a KAM. In companies which had multiple operating streams, revenue recognition becomes more complex, and thus was illustrated as a KAM.

The KAM category independent variable was measured as the word count relating to the category of KAM expressed as a percentage of the total word count of the KAM disclosure section.

Table 2

Summary of Category of Key Audit Matters

KAM CATEGORY	DESCRIPTION
$\boldsymbol{Valuation\ of\ Financial\ Asset\ (VFA)}$	Complex valuation of accounts receivable, loans and other debt instruments.
$\boldsymbol{Valuation\ of\ Financial\ Instrument\ (VFI)}$	Complex valuation of equity shares, investments in associates, and joint ventures.
$\boldsymbol{Valuation\ of\ Intangible\ Assets\ (VIA)}$	Goodwill measurement and estimation of intangible assets useful lives.
$\boldsymbol{Valuation\ of\ Liabilities\ (VL)}$	Estimated future expenditure relating to training costs, rehabilitation costs, litigation costs, and retirement benefits.
$\boldsymbol{Valuation\ of\ Non-Current\ Assets\ (VNCA)}$	Complex valuation of non-current assets, relating primarily to fair valuing investment property.
$\boldsymbol{Valuation\ of\ Inventory\ (VInv)}$	Measurement of the accuracy of inventory, and inventory provisions.
$\boldsymbol{Valuation\ of\ Insurance\ Contract\ (VIns)}$	Complex valuation of insurance contract assets and liabilities.
$\boldsymbol{Share\ Based\ Payments\ (SBP)}$	Complex valuation of share-based payment schemes.

$\boldsymbol{Taxation}$ $(\boldsymbol{Tax})$	Calculation of income and deferred taxation.
$\boldsymbol{Related\ Party\ Transaction}$ $(\boldsymbol{RPT})$	Intercompany and intergroup transactions.
$\boldsymbol{Consolidation}$ $(\boldsymbol{Con})$	Re-measurement of assets and liabilities upon consolidation of separate business entities.
$\boldsymbol{Discontinued\ Operation}$ $(\boldsymbol{DO})$	Complex valuation of discontinued operations held for sale.
$\boldsymbol{Supplier\ Rebates}$ $(\boldsymbol{SR})$	Recognition and measurement of discounts received on purchase of stock from suppliers.
$\boldsymbol{Going\ Concern}$ $(\boldsymbol{GC})$	Assessing managements estimates of whether the company continues to be a going concern.
$\boldsymbol{Control\ Environment}$ $(\boldsymbol{CE})$	Disclosures on new software system implementations and financial irregularities.
$\boldsymbol{Revenue}$ $(\boldsymbol{Rev})$	Recognition and measurement of revenue.

3.3.3.3 Control variables

Control variables are variables which may potentially influence the dependent variable (Leedy & Ormrod, 2013). The control variables in the study comprised of whether an integrated report was released alongside the financial statement, the audit opinion disclosed for the firm, the dividend yield of the firm, the change in cash flows from operations of the firm, the change in attributable earnings to shareholders of the firm, the firm size, whether or not the firm's financial statements had been restated, and the firm's sector. The integrated report, audit opinion, financial statement restatements and firm sector were treated as indicator variables, which are variables that have a non-numerical nature (Gujarati & Porter, 1999). The control variables will be outlined in further detail in the following section.

The integrated report was measured as an indicator variable, where if a company had released an integrated report alongside their financial statements it was attributed an artificial value of 1, and if not, attributed a value of 0. This information was gained from the IRESS database which outlines the stock exchange announcements which state at which date the integrated

report was released to the public. This was used to determine whether an integrated report was released alongside the financial statements.

The audit opinion was measured as an indicator variable. There are 4 types of audit opinions which can be issued, namely: unqualified opinion, qualified opinion, adverse opinion, and a disclaimer (IAASB, 2015b). The audit opinion can be further consolidated, to that of a modified or unmodified audit report. If an audit report contains an unqualified audit opinion, then the audit report is unmodified, conversely, any other opinion will result in a modified report. A value of 1 was attributed to a company with an unmodified audit report, and 0 for a modified audit report.

The dividend yield was measured as the current dividend for the period expressed as a percentage of share price (Correia et al., 2015). The dividend yield figures per company were extracted from the IRESS database for the appropriate financial year.

The change in cash flows from operation was measured as the percentage change from the previous period's operating cash flow to the current financial year's operating cash flow. The financial metric was gained from the IRESS database.

The change in attributable earnings was measured as the percentage change from the previous period's attributable earnings to the current financial year's attributable earnings. The attributable earnings illustrate earnings which are to be distributed to shareholders. The financial metric was gained from the IRESS database.

Firm size was measured as the natural logarithm of total assets, which is consistent with other studies which have attempted to control for firm size (Hall & Weiss, 1967; Uyar, 2009). The financial statement line item of total assets was gained from the IRESS database.

Financial statement restatements were measured as an indicator variable, where if a company had restatements in their previous financial year it was attributed a value of 1, and if not, attributed a value of 0. The restatements were assessed by inspecting the company's financial statements and observing whether line items from the previous financial year had been restated.

The firm sector was measured as an indicator variable. The firm sectors were taken from the JSE classification of firm sectors, which were portrayed on the IRESS database. There were 10 sectors outlined on the database, which consisted of basic materials, consumer goods, consumer services, financials, health care, industrials, oil and gas, technology, telecommunications, and utilities. If a company was included in a specific firm sector, the specific firm sector was attributed a value of 1 and the other sectors a value of 0.

3.3.4 Assumptions of the multiple regression model

A regression model has assumptions which must be met before reliance may be placed on the model. The assumptions underpinning the multiple regression model related to a normal distribution, whether the independent variables are unrelated to the error term, that the variance in the regression model is homoscedastic, and finally that there is no presence of multicollinearity between the predictor variables. An assessment of whether the assumptions of the multiple regression model were met was conducted to ensure the validity of the model.

3.3.4.1 Normality

In order to ensure the explanatory power of the regression, the data within the model should approximate a normal distribution (Cameron & Windmeijer, 1997). To assess the normal distribution of the dependent variable, both a Kolmogorov-Smirnov and Shapiro-Wilk goodness of fit tests were conducted on the market to book ratio of the firms in the sample using SPSS. The Kolmogorov-Smirnov and Shapiro-Wilk show whether the data is statistically significantly different from a normal distribution (Shapiro & Francia, 1972). In line with statistical best practice, the normality of the data was tested in its original form and in its logarithmic form (Cameron & Windmeijer, 1997; Stephens, 1974).

The table below illustrates the results of the normality tests on the dependent variable in its original form:

Table 3

Original Data Test of Normality

Tests of Normality

	Kolmogorov-Smirnov			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Market Value Over Book Value of Equity	.169	160	.000	.758	160	.000

Following from this, the normality tables represent the dependent variable in its logarithmic form, with a base function of 10 as suggested by Stephens (1974):

Table 4

Logarithmic Data Test of Normality

Tests of Normality

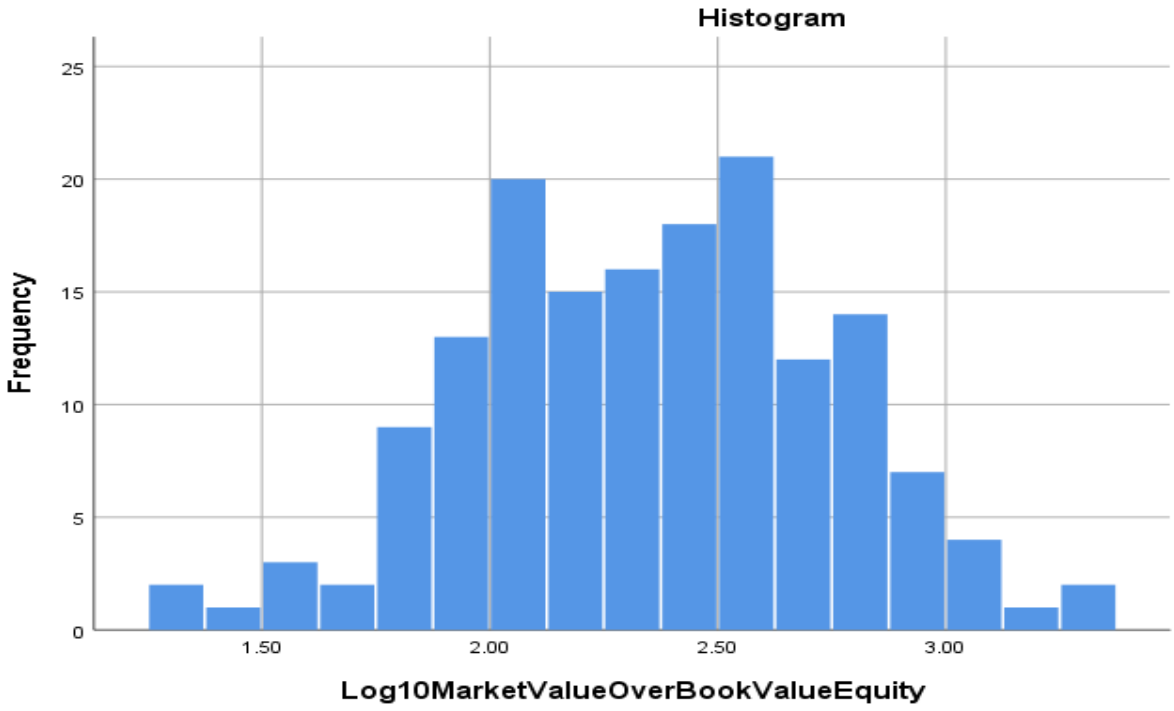
	Kolmogorov-Smirnov			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.

Log10 Market Value Over Book Value of Equity	.046	160	.200	.995	160	.813

As illustrated by the tables above, the data tends toward a normal distribution when transformed into a logarithmic function with a base function of 10. The normal distribution of the data is confirmed with both the Kolmogorov-Smirnov and Shapiro-Wilk test showing that the market to book ratio is not statistically significantly different from a normal distribution when transformed into its logarithmic form. An insignificant value of 0.2 and 0.813 for the Kolmogorov-Smirnov and Shapiro-Wilk tests were rendered respectively. Below is the histogram and normal Q-Q plot for the dependent variable's logarithmic form.

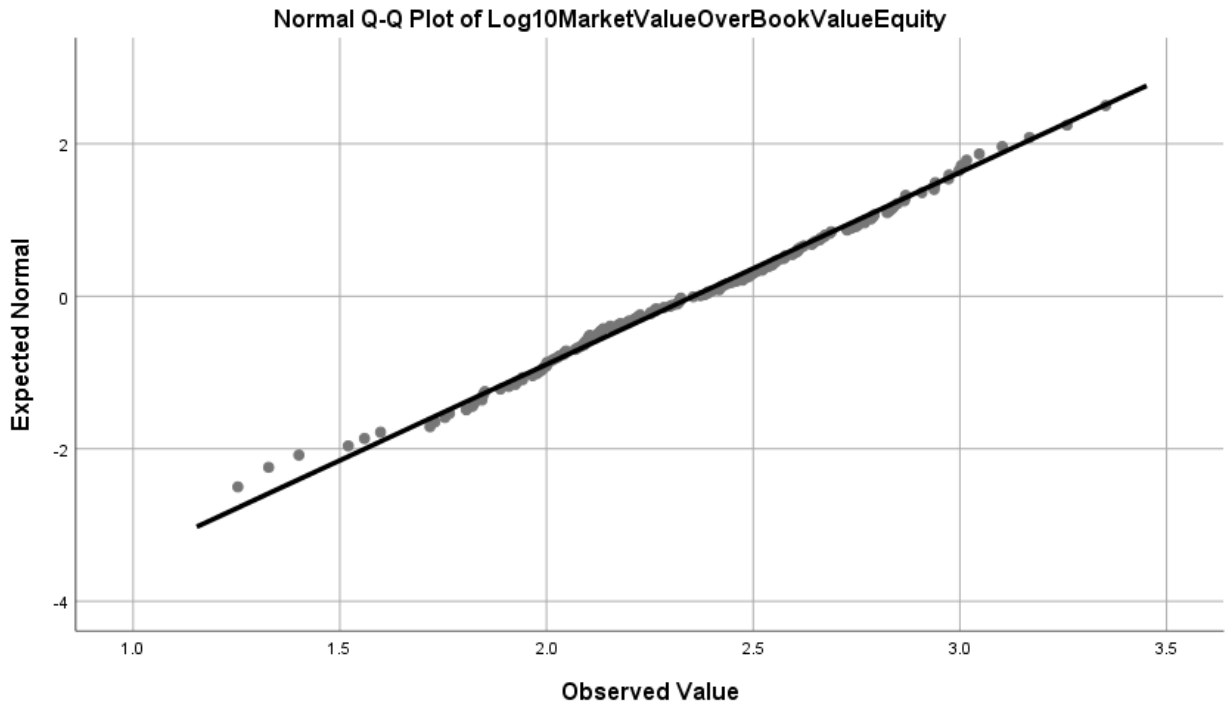
Histogram 1

Log10 Market Value Over Book Value Equity



Normal Q-Q Plot

Log10 Market Value Over Book Value Equity



Normality has been achieved both through the Kolmogorov-Smirnov and Shapiro-Wilk tests. Visually, this is confirmed, with a histogram and normal Q-Q plot showing a similarity to a normal distribution. Stephens (1974) outlines that the Shapiro-Wilk normality test is more robust than the Kolmogorov-Smirnov normality test, as such, for the purposes of this research, the normality of the data will be in reference to the figures displayed for the Shapiro-Wilk normality test. This presents no concern as the Shapiro-Wilk normality test is statistically insignificant, therefore the data is normally distributed which enhances the validity of the regression model.

The central limit theorem, as discussed by Rosenblatt (1956), outlines that the sampling distribution of a sample mean tends toward a normal distribution as the sample size gets larger. This indicates that if a large enough sample is present in the study, all data tends toward a normal distribution. The threshold for the sample size to approximate a normal distributions is generally 30 observations (Davidson & Aminian, 2004; Kwak & Kim, 2017). In the current study, 160 observations had been included in the sample, which was greater than the 30-observation threshold for the central limit theorem to hold true. Accordingly, the regression should tend toward a normal distribution due to the sample size being sufficiently large enough.

3.3.4.2 Independence of the variables to the error term

The error term in a regression model illustrates unexplained variances from the regression line to the observations. Within a multiple regression, multiple predictor variables each have

their own error terms. It may be the case where an error term of a predictor variable is manipulating the explanatory power of another predictor variable. This may contribute to a type II error occurring, where the regression model will fail to reject an incorrect null hypothesis (Draper et al., 1966). In order to mitigate this occurrence, the variables were assessed for their independence from the error term, which was evaluated by a Durbin-Watson test (Neter, Kutner, Nachtsheim, & Wasserman, 1996).

A Durbin-Watson test assesses for the independence of the error terms in a regression model, calculating a value between 0 and 4. Where error terms are independent, the score given from the Durban-Watson test should tend toward a value of 2. The Durban-Watson test has a critical value, which illustrates where the independence of error terms holds most true, between 1.5 and 2.5.

The Durbin-Watson test was applied to the regression model and returned a critical value of 1.581 (refer to Table 8). The critical value falls on the lower bound of the critical range, however, remains within the critical range of 1.5 and 2.5. Thus, the error terms in the regression was seen to be independent from the predictor variables, enhancing the validity of the regression.

3.3.4.3 Homoscedasticity

Homoscedasticity refers to the variance of the error terms remaining constant across all levels of the predictive value (Draper et al., 1966). In order to determine whether the predictor variables are homoscedastic along with the dependent variable, a one way analysis of variance (ANOVA) was computed (Hoaglin & Welsch, 1978).

An ANOVA is designed to compare the means and variances of two or more samples, and return a significant value if the predictor variable error terms produce variances which do not differ significantly from each other (Tabachnick, Fidell, & Ullman, 2007). If the data produces predictor variable variances which do not differ significantly from each other, the data is said to be homoscedastic, whereas if there are significant differences, the data is termed heteroscedastic (Hoaglin & Welsch, 1978).

An ANOVA was run on the data with the results being showcased below:

Table 5

ANOVA Output Table

ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	13.571	28	.485	5.512	.000
	Residual	11.520	131	.088		
	Total	25.091	159			

The results of the ANOVA portray that the variances between the predicator variables are not significantly different. Indeed, the significance score returned by the ANOVA of 0.000 is significant at a 99% confidence interval. This confirms that the variables in the study have similar variances and therefore are homoscedastic, further enhancing the validity of the regression model.

3.3.4.4 Multicollinearity

Within a multiple regression study, there is a risk that the variables within the study are correlated with each other (Draper et al., 1966). Multicollinearity refers to the event in which two or more explanatory variables within the study are highly correlated. The presence of multicollinearity may cast doubt on the validity of the regression model.

To test for multicollinearity, the variance inflation factor (VIF) was computed for each of the variables present in the study. If a VIF score of 10 or above was recorded for a variable, then the variable is seen to be subject to multicollinearity (Chatterjee & Hadi, 2015; Salmerón, García, & García, 2018). In Table 6 the VIF scores for each predictor variable in the study are presented. The valuation of intangible assets and the financial services sector were excluded from the multicollinearity analysis.

Table 6

Multicollinearity Diagnostic Table

Multicollinearity Diagnostic

Model		VIF
1	KAM Number	1.689
	Valuation of Financial Assets	1.669
	Valuation of Financial Instruments	1.735
	Valuation of Liabilities	1.673
	Valuation of Non-Current Assets	2.269
	Share Based Payments	1.222
	Taxation	1.647

	Related Party Transactions	1.252
	Consolidation	1.698
	Discontinued Operations	2.425
	Supplier Rebates	1.378
	Valuation of Inventory	1.765
	Going Concern	1.242
	Control Environment	1.227
	Valuation of Insurance Contracts	1.771
	Revenue	1.519
	Firm Size	1.750
	Dividend Yield	2.098
	Earnings Change	1.225
	Operating Cash Flow Change	1.150
	Restatement	1.277
	Basic Materials	1.996
	Consumer Goods	1.634
	Consumer Services	2.947
	Health Care	1.455
	Industrials	1.797
	Technology	1.645
	Telecommunications	1.519

As can be seen from Table 6, no VIF score exceeds the cut-off point of 10 (Chatterjee & Hadi, 2015; Salmerón et al., 2018). The maximum VIF score recorded for all predictor variables included in the regression was 2.947, relating to the consumer services industry sector. In conclusion, there was no strong evidence of multicollinearity present in the model, which enhances the validity of the regression.

CHAPTER 4: RESULTS AND DISCUSSION

In this chapter, the results of the multiple regression will be outlined and discussed. As explained in the methodology section, a multiple regression was run on the variables in the study to determine whether KAMs were value relevant. Firstly, the descriptive statistics will be analysed. Thereafter, the results from the application of a multiple regression to the data will be set out. Finally, the regression results will be interpreted and discussed.

4.1 Descriptive statistics

In this section the descriptive statistics relating to the variables present in the study will be discussed. Table 7 below illustrates the descriptive statistics relating to the range of values, the minimum value, the maximum value, the mean value, and finally the standard deviation value of the variables which were not indicator variables.

Table 7

Descriptive Statistics

Descriptive Statistics

	Range	Minimum	Maximum	Mean	Std. Deviation
Log10 Market Value Over Book Value of Equity	2.10	1.25	3.35	2.3552	.39725
KAM Number	6	1	7	2.71	1.221
Valuation of Financial Assets	1.00	.00	1.00	.0910	.21115
Valuation of Financial Instruments	1.00	.00	1.00	.1174	.20217
Valuation of Intangible Assets	1.00	.00	1.00	.1832	.27419
Valuation of Liabilities	1.00	.00	1.00	.0463	.13703
Valuation of Non-Current Assets	1.00	.00	1.00	.1974	.27706
Share Based Payments	.64	.00	.64	.0188	.09247
Taxation	.54	.00	.54	.0438	.10205
Related Party Transactions	.36	.00	.36	.0079	.04570
Consolidation	1.00	.00	1.00	.1005	.19110
Discontinued Operations	.59	.00	.59	.0102	.06311
Supplier Rebates	.72	.00	.72	.0180	.09251
Valuation of Inventory	1.00	.00	1.00	.0532	.15517
Going Concern	.31	.00	.31	.0049	.03607
Control Environment	.60	.00	.60	.0129	.06716
Valuation of Insurance Contracts	1.00	.00	1.00	.0469	.15726
Revenue	.58	.00	.58	.0476	.12889
Firm Size	8.88	19.50	28.39	24.4109	1.55000
Dividend Yield	72.00	.00	72.00	4.6015	7.15842

Earnings Change	4294.23	-2322.22	1972.01	2.7467	336.71619
Operating Cash Flow Change	14580.25	-1974.94	12605.31	65.6890	1032.61741

4.1.1 Mean

The mean is a descriptive statistic which portrays the average of the variable across all companies within the sample (Tabachnick et al., 2007). The mean number of KAMs disclosed per entity was 2.71. This indicates that approximately 3 KAMs per company is disclosed on average. In the sample of 160 companies, KAMs surrounding the valuation of intangible assets and the valuation of non-current assets occurred 18.32% and 19.74% of the time respectively. This entails that the most commonly disclosed KAMs related to valuations and fair value measurements. This is unsurprising, as fair value measurement involves the use of judgment and estimates, which are common areas of risk in audit clients (IAASB, 2013).

The most uncommon KAM disclosed related to disclosures concerning the going concern of the entity, with 0.49% of KAM disclosures in the sample relating to management estimates of the going concern of the company. This is not unusual, as the going concern assessment is meant to be separately disclosed in the audit report per ISA 570 if there is a material uncertainty which exists on the entities ability to continue as a going concern (IAASB, 2009e). Furthermore, in a review of the KAM section conducted by the IAASB, it was noted that firms had erroneously included going concern uncertainty in the KAM section of the audit report (Cloete & Sikhakhane, 2019). This indicates that some auditing firms misunderstand the appropriate disclosure concerning KAMs and going concern uncertainties, as was found by the IAASB in their review of ISA 701 (Cloete & Sikhakhane, 2019).

4.1.2 Standard deviation

The standard deviation represents how dispersed the data in the sample is from the mean (Tabachnick et al., 2007). Larger standard deviations indicate that the data is more dispersed from the mean. For the number of KAMs, the standard deviation was 1.221 number of KAMs. This indicates that the standard deviation from the average number of KAMs disclosed of 2.71 was 1.221 number of KAMs. This indicates that the majority of KAMs clustered around 1 to 4 KAMs disclosed.

In terms of the category of KAMs, the highest standard deviation of 27.706% was recorded for the valuation of non-current assets. This showcases that the length of disclosure concerning the valuation of non-current assets was the most inconsistent of the KAM categories. This seems to show that KAM disclosures relating to the impairment of non-current assets and the valuation of investment property were not subject to generic disclosures through the discrepancy in length of the KAM disclosures. Other categories of KAMs which were highly

dispersed, with a standard deviation greater than 20%, related to the valuation of financial assets, financial instruments, and intangible assets. KAMs pertaining to valuations seem to attract the largest discrepancy in the length of the disclosures. The lowest standard deviations in the category of KAMs, with a standard deviation below 5%, concerned related party transactions and going concern issues, with standard deviations of 4.57% and 3.607% respectively. This indicates that disclosures surrounding these categories of KAMs were similar in length. This could be due to disclosures surrounding going concern issues being brief as they are specifically disclosed under a separate section in the audit report per ISA 570 (IAASB, 2009e).

4.1.3 Maximum and minimum

The maximum value is the highest recorded value for the variables in the sample, whereas the minimum value is the lowest recorded value for the variables (Tabachnick et al., 2007). The maximum number of KAMs disclosed was 7, whereas the minimum amount of KAMs disclosed was 1. This is in line with Reintjes (2015b) who stated that it would be highly unlikely that at least one KAM would not be disclosed in the audit report for listed entities.

As stated in the methodology, the measurement for each category of KAMs was expressed as a percentage in relation to the total word count of the KAM section. As such, the maximum value would be 1, indicating that 100% of the KAM section relates to that particular KAM category, or 0, indicates that a particular KAM category was not disclosed in an entity's audit report. Of the sample, there were 8 categories of KAMs which were solely disclosed in the audit report. In the majority of cases, these categories related to the valuation of items, with the valuation of financial assets, financial instruments, intangible assets, liabilities, non-current assets, inventory, and insurance contracts. The other category with a maximum value of 1 related to KAMs concerning consolidations. All categories of KAMs had a minimum value of 0. This indicates that there is no category which was disclosed for all 160 companies in the sample.

4.2 Regression results

The model fit of the multiple regression are contained in Table 8, using an independent variable of market to book ratio, as shown by Log10 Market Value Over Book Value Equity (Log10MV). The predictor variables within the study which were the independent variables related to the number of KAMs, as shown by KAMN, and the category of KAMs, showcased by VFA, VFI, VL, VNCA, SBP, Tax, RPT, Con, DO, SR, VInv, GC, CE, VIns, and Rev (refer to Table 2). The predicator variables relating control variables were IR, FS, DY, EC, CFOC, UO, Res (refer to Table 1). Firm sector was comprised of the following sectors: Basic Materials (BM), Consumer Goods (CG), Consumer Services (CS), Health Care (HC), Industrials (Ind),

Oil and Gas (OG), Technology (Tech), Telecommunications (TCom), and Utilities (Uti). The valuation of intangible assets and the financials industry sector were excluded from the regression analysis.

Table 8

Multiple Regression Model Summary Table

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.735	.541	.443	.29654	1.581

Table 8, the model summary table, indicates, evidenced by the *Adjusted R Square* column, how much of the variability in the dependent variable is explained by the predictor variables. The significance of each of the predictor variables is summarised in Table 9.

Table 9

Regression Significance Table

Regression Outputs

Model		Unstandardised Coefficients Beta	Unstandardised Coefficients Std. Error	Standardised Coefficients Beta	t	Sig.
1	(Constant)	3.474	.490		7.087	.000
	KAM Number	-.011	.025	-.035	-.453	.651
	Valuation of Financial Assets	.340	.144	.181	2.361	**.020***
	Valuation of Financial Instruments	.206	.153	.105	1.347	.180
	Valuation of Liabilities	.334	.222	.115	1.503	.135
	Valuation of Non-Current Assets	-.185	.128	-.129	-1.447	.150
	Share Based Payments	.990	.281	.231	3.523	**.001****
	Taxation	.019	.296	.005	.063	.949
	Related Party Transactions	.385	.576	.044	.669	.505
	Consolidation	.115	.160	.055	.717	.475
	Discontinued Operations	.455	.580	.072	.785	.434
	Supplier Rebates	.697	.298	.162	2.335	**.021***
	Valuation of Inventory	.208	.201	.081	1.035	.302
	Going Concern	-.016	.727	-.001	-.022	.982
	Control Environment	-.751	.388	-.127	-1.936	.055

Valuation of Insurance Contracts	.451	.199	.179	2.268	**.025***
Revenue	.806	.225	.262	3.585	**.000****
Firm Size	-.049	.020	-.191	-2.443	**.016***
Dividend Yield	-.015	.005	-.271	-3.157	**.002****
Earnings Change	.000	.000	.039	.591	.556
Operating Cash Flow Change	-.000	.000	-.049	-.770	.443
Restatement	-.010	.053	-.013	-.187	.852
Basic Materials	-.043	.096	-.037	-.447	.655
Consumer Goods	-.053	.114	-.036	-.469	.640
Consumer Services	.252	.103	.248	2.444	**.016***
Health Care	.297	.138	.153	2.149	**.033***
Industrials	-.189	.097	-.155	-1.947	.054
Technology	.110	.173	.048	.638	.525
Telecommunications	.138	.141	.071	.975	.331

Where *, and **, indicate variables which are significant at a 95% and 99% confidence interval respectively.

Table 9 showcases, among other information, the unstandardised coefficients, which illustrates how the dependent variable moves in terms of a one unit change in the predictor variables (Tabachnick et al., 2007). The control variables of UO and IR were excluded from the analysis as the variables had a constant term of 1, therefore not influencing the regression model. Similarly, the control variables of industry sector pertaining to OG and Uti were excluded from the analysis as both control variables had constant terms of 0.

4.3 Discussion of the results

4.3.1 Regression output and function

The result from Table 8 indicates an *Adjusted R Squared* value of 44.3%. This indicates that 44.3% of the change in the market to book ratio of the firms is explained by the predictor variables in the study. This illustrates that the model fit has moderate power in explaining the effect of the predictor variables of the market to book ratio of the firm. The regression function model from the analysis is presented below:

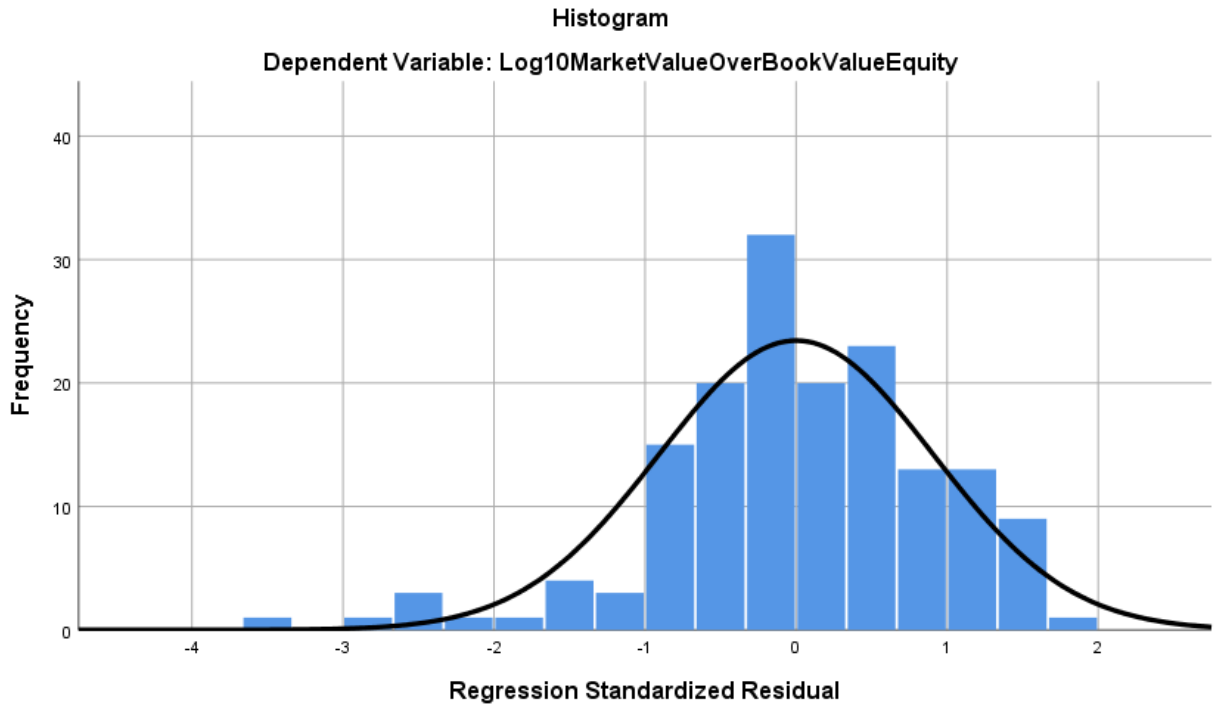
Equation 2: Regression Function

$$\text{Log10MV} = 3.474 - 0.011\text{KAMN} + 0.34\text{VFA} + 0.206\text{VFI} + 0.334\text{VL} - 0.185\text{VNCA} + 0.99\text{SBP} + 0.019\text{Tax} + 0.385\text{RPT} + 0.115\text{Con} + 0.455\text{DO} + 0.697\text{SR} + 0.208\text{VInv} - 0.0168\text{GC} - 0.751\text{CE} + 0.451\text{VIns} + 0.806\text{Rev} - 0.049\text{FS} - 0.015\text{DY} + 0.000\text{EC} - 0.000\text{CFOC} - 0.01\text{Res} - 0.043\text{BM} - 0.053\text{CG} + 0.252\text{CS} + 0.297\text{HC} - 0.189\text{Ind} + 0.11\text{Tech} + 0.138\text{TCom}.$$

The regression function appears to follow a normal distribution, with slight skewness to the left as shown by Histogram 2:

Histogram 2

Regression Function



The normality of the distribution within the regression model illustrates the central limit theorem. Where more than 30 data points have been included in the regression model, the regression model will tend to a normal distribution (Davidson & Aminian, 2004; Kwak & Kim, 2017). Although there appears to be slight skewness to the left, Stephens (1974) explains that a skewed distribution does not significantly affect the validity of a regression model.

4.3.2 Regression significance table interpretation

Table 9 illustrates which variables had significant predictive power in explaining the change in the market to book ratio of a firm. From Table 9, the following independent variables had significant power in explaining the variance in the dependent variable at a confidence level of 95%: the valuation of financial assets, supplier rebates, and the valuation of insurance contracts. At a confidence level of 99%, the following independent variables had significant power in explaining the dependent variable: share based payments and revenue.

4.3.3 Regression significance table discussion

By examining the significant independent variable as outlined in Table 9, one may make interesting conclusions concerning the value relevance of KAMs. As has been discussed, the market to book ratio of a firm is seen as a proxy for value relevant information, therefore any significant explanation of the premium that investor pay over and above the book value of equity is an indicator of value relevant information.

4.3.3.1 Number of key audit matters

One of the main objectives in the development of KAMs was to add additional transparency to the audit of financial statements (Botez, 2017; Sneller et al., 2017). With additional transparency regarding the audit of a company's financial statements, that audit report will become more entity specific, which provides value relevant information to users (Masdor & Shamsuddin, 2018).

Table 9 illustrates that the number of KAMs disclosed in the audit report has no significant power in explaining the variance in the market to book ratio of firm. This is an indicator that the number of KAMs disclosed in the audit report is not seen as value relevant to users. This echoes the sentiments of Segal (2019) who found that experts in the field of auditing felt that KAM disclosures add no informational value to the audit report. The finding seems to confirm the position by Church, Davis, and McCracken (2008) that audit report information is mainly symbolic rather than value relevant and would not modify the behaviour of users. This is further confirmed by Bédard et al. (2014) who found that, regardless of the number of disclosures of justification of assessments (the equivalent to KAMs in France), there was no clear market reaction to the disclosures.

4.3.3.2 Category of key audit matters

In terms of the category of KAMs, many interesting outcomes arose. As stated above, certain categories of KAMs did have significant power in explaining the variance in the market to book ratio of a firm, therefore illustrating that these specific types of KAM disclosures are considered value relevant to users. This indicates that the content of the KAM disclosures is important to users as discussed by Segal (2017) and not merely the number of KAMs disclosed.

Table 9 indicates that the valuation of financial assets, supplier rebates from purchases of stock, the valuation of insurance contracts, the disclosure and computation surrounding share-based payment structures, and the recognition and measurement of revenue were seen to have significant power in explaining the variance in the market to book ratio of firms, signalling value relevant information.

The valuation of financial assets related to the measurement of the financial assets which the company had invested in, which were usually liquid investments. Unsurprisingly, many of the KAMs relating to the valuation of financial assets were for companies operating in the financial sector of the JSE. The valuation of financial assets seems to be more value relevant than the valuation of financial instruments; this indicate that investors place greater value on the confidence that a firm has measured and disclosed their future cash inflows from financial assets rather than financial instruments which pertained to equity investments. This finding is consistent with the findings from Charitou et al. (2000) who found that information concerning cash flows was positively associated with share price movements. Furthermore, this finding is reiterated in the studies conducted by Gee-Jung (2009), Wilson (1986), Bowen et al. (1986), Bowen et al. (1987), and Cheng et al. (1997) who all found that information concerning cash flows were value relevant.

Supplier rebates related to the reduction of inventory costs through receiving supplier rebates on purchases of stock. This indicates that added disclosures surrounding how the firm negotiates supplier contracts and establishes goodwill with suppliers is value relevant to users. This KAM was particularly important for retail companies operating in the consumer services industry, such as Dis-Chem Pharmacies and Pick N Pay, who engage in a large amount of stock purchases throughout the financial year. This finding is consistent with the belief that added information concerning business practices in cultivating beneficial relationships with suppliers is valuable for users (Gamerschlag, 2013; Holler, 2009). Furthermore, effective negotiation of supplier contracts impacts the profitability of the firm, through a reduction in the cost of stock. This indicates that the ability of the firm to maximise profitability when negotiating contracts is seen as value relevant for users through effective management of costs (Livnat & Zarowin, 1990).

The valuation of insurance contracts illustrated the actuarial assumptions that were included in the measurement of insurance contracts. This area involves complex calculations and a high degree of judgment, consequentially it presents a significant risk for the audit process, in particular for insurance companies which contain a large amount of insurance contracts in their financial statements (IAASB, 2013). All insurance companies sampled from the population had KAMs relating to the valuation of insurance contracts, as they represent a major component of their cash flows through assessing the significance of claims which would possibly need to be paid out. This reiterates the position that information concerning cash flows is value relevant to users (Bowen et al., 1987; Charitou et al., 2000; Cheng et al., 1997; Wilson, 1986). Furthermore, the complexity inherent in measuring assets and liabilities from insurance contracts leads to an increased risk that they are inaccurate. It appears that users place value on additional disclosures in ensuing that highly complicated accounting

transactions, which have a significant bearing on the liquidity position of the company, are measured correctly which is consistent with prior research (Chalmers, Clinch, & Godfrey, 2011; Chamisa, Mangena, & Ye, 2012; Elshandidy, 2014; Tsalavoutas & Dionysiou, 2014).

Share-based payments related to the recognition and measurement of share-based payment schemes. KAMs relating to the recognition and measurement of share-based payments were significant at the 99% confidence interval. In line with the above discussion, areas which involve significant estimation and complexity in their accounting treatment, and which impact profitability and cash flows, require added disclosure, which users view as value relevant. This finding is consistent with Tsalavoutas and Dionysiou (2014) who highlighted that disclosures concerning IFRS 2 share-based payments would be value relevant to users, specifically for the number and weighted average exercise prices of the share options. A link to corporate social responsibility may be highlighted within this KAM, as a large part of the share-based payments schemes related to BBBEE transactions. Disclosures surrounding corporate social responsibility initiatives relating to BBBEE have been shown to create shareholder wealth, and thus may be an indicator of future profitability for shareholders which is seen as value relevant information (Collins et al., 1997; Wolmarans & Sartorius, 2009). In addition, the impact of earnings from the recognition and measurement of share-based payments would be value relevant to users, as information concerning profitability is value relevant (Collins et al., 1997; Goodwin & Ahmed, 2006).

The revenue category pertained to the firms' recognition and measurement of revenue. KAMs surrounding the recognition and measurement of revenue were value relevant at the 99% confidence interval. This finding confirms the position of Collins et al. (1997) and Goodwin and Ahmed (2006) who found that earnings remain value relevant to users. IFRS 15, which governs the recognition and measurement of revenue, is a complex standard to apply, thus added disclosure surrounding complex accounting treatment pertaining directly to earnings appear to be value relevant to users. IFRS 15 (2014b) is a newly implemented standard which has increased the risk surrounding the accuracy of reporting revenue figures, and consequentially earnings for the period. It seems that users find added disclosures concerning the accuracy of the revenue figure value relevant. Earnings, and therefore revenue, highlights a piece of information which users may use to evaluate the performance of the company and its management (Livnat & Zarowin, 1990). Revenue can be viewed as a proxy to judge management's performance and added disclosure concerning the accuracy of the revenue figure would afford investors added confidence in the appraisal of the company's management performance, which would signify value relevant information.

As the significant independent variables have been explained, the next section will be devoted to briefly outlining some insights into the insignificant categories of KAMs, which were not seen as value relevant.

Table 9 illustrates that the least significant category of KAM related to disclosures surrounding taxation of the entity. The tax computation in many cases was complex, specifically for companies with foreign subsidiaries which have their own taxation rules. However, this category of the KAM disclosure was not viewed as bringing value relevant information to investors. Possible reasons for this would be that, even though there are estimations involved in tax computations, the foreign tax authority will issue their own assessment over what the company's tax liability will be in any case, thereby nullifying the inherent estimation in the tax computation. The taxation KAM also related to the computation of deferred tax assets and liabilities. The findings of this research stand in contrast with the literature surrounding the value relevance of deferred tax, as they appear to be value relevant to users (Ayers, 1998; Lynn, Seethamraju, & Seetharaman, 2008).

An interesting outcome of the research was that disclosure surrounding the firm's control environment was not seen as value relevant for investors. This predictor variable was the closest category of KAM to being significant from the data, as it would have been significant at the 94.5% confidence level. The firm's control environment related predominantly to whether any instances of suspected fraud had occurred, whether a new information technology system had been implemented in the company, and the general controls within the company. This result stands in contrast to multiple studies which have established that the control environment indicates the level of corporate governance in the entity, which is value relevant to users (Ammann, Oesch, & Schmid, 2011; Cheung, Thomas Connelly, Limpaphayom, & Zhou, 2007; Goncharov, Werner, & Zimmermann, 2006; Ntim, Opong, & Danbolt, 2012).

In conclusion, value relevant information related to KAMs which dealt with financial line items pertaining to profitability and cash flows. Instances of which were the valuation of financial assets, supplier rebates, the valuation of insurance contracts, the recognition and measurement of share-based payments, and revenue.

CHAPTER 5: CONCLUSION

Throughout the course of this research, the value relevance of KAMs were evaluated. KAMs are a mandated audit report disclosure requirement for entities with a financial year end on or after 15 December 2016. Value relevance studies are concerned with evaluating the value relevance of financial and non-financial information (Ohlson, 1995). Prior studies have attempted to assess the value of KAMs, with significant contributions from research conducted by Segal (2017, 2019), Sirois et al. (2018), and Bédard et al. (2014).

The research performed over the value relevance of KAMs was conducted under a quantitative lens. This will provide a contribution to the existing literature surrounding KAMs, as a majority of the studies on KAMs is premised in qualitative research in a South African context (Segal, 2017, 2019). The intended purpose of KAM disclosures was to provide users with relevant information. By assessing the value relevance that users place on KAM disclosures the objective of ISA 701 was assessed and may be used by the IAASB going forward in evaluating whether ISA 701 has fulfilled its purpose.

The value relevance of KAMs was assessed by using the market to book ratio as a proxy for value relevant information. Two independent variables were proposed in illustrating KAM disclosures which could potentially be value relevant, namely the number of KAMs disclosed and the category of KAMs disclosed. This resulted in two hypotheses being explored, the first being that the number of KAMs were value relevant to users, and secondly that the category of the KAMs disclosed were value relevant to users. A multiple regression was applied to the variables in the study, with the conclusion of the results discussed in Section 5.1.

5.1 Conclusion surrounding the number of key audit matter disclosures

Hypothesis 1 related to whether the number of KAMs disclosed in the audit report would be seen as value relevant to users. This was assessed by conducting a multiple regression and evaluating whether the number of KAMs disclosed in the audit report significantly explained the variation in the market to book ratio of a firm. Based on the findings of the analysis, as seen in Table 9, there is no significant explanatory power in the number of KAMs on the market to book ratio of a firm. This indicates that the number of KAM disclosed is not seen as value relevant for users.

This finding is consistent with those outlined by Segal (2019) who, upon interviewing various professional with expertise in auditing, found that participants felt that disclosures of KAMs were not enhancing the informational value of the audit report. Furthermore, the finding supports the outcomes found by Church et al. (2008) and Bédard et al. (2014) that the number of KAMs disclosed do not influence the behaviour of users.

In conclusion, through the results obtained relating to the value relevance of the number of KAMS disclosed in the audit report, the null hypothesis is accepted, in that the number of KAMs disclosed is not value relevant.

5.2 Conclusion surrounding the category of key audit matter disclosures

Hypothesis 2 related to whether the categories of KAMs were viewed as value relevant to users. This was assessed by separating the type of KAMs into 16 categories and evaluating whether the type and content of the KAMs were value relevant to users. As seen in Table 9, 5 of the 16 categories of KAMs disclosed were value relevant. The following categories of KAMs were seen as value relevant: the valuation of financial assets, supplier rebates from purchases of stock, the valuation of insurance contracts, share-based payment estimations and disclosures, and the recognition and measurement of revenue.

KAM disclosures surrounding areas relating to profitability were value relevant for users, namely: supplier rebates, share-based payments, and revenue. This confirms the position of Collins et al. (1997) and Goodwin and Ahmed (2006) who showcase that earnings, and therefore profitability, remain value relevant information to users. It may be concluded that KAM disclosures surrounding areas of the audit which dealt specifically with financial line items which would have a salient effect on profitability were value relevant to users. In addition, KAMs concerning the future cash flows of the entity were value relevant to users, namely: the valuation of financial assets, insurance contracts, and share-based payments. This result is consistent with the conclusions reached in studies conducted by Charitou et al. (2000), Bowen et al. (1987) and Cheng et al. (1997) who illustrated how cash flows remain value relevant content for users. This information also supports that added information concerning cash flows is value relevant as investors view cash flows as highly important information when informing their investing decisions (Barton et al., 2010). Considering the above, the category of the KAM disclosed was seen as value relevant, and therefore the null hypothesis is rejected.

5.3 Final remarks and areas for future research

The results and conclusions discussed in the context of this research should be read with caution when extrapolating the results to unlisted companies or firms not primarily listed on the JSE, as ISA 701 (2015c) is only mandated to be disclosed for companies primarily listed on the JSE. Non-listed companies may voluntarily disclose KAMs. Listed companies and unlisted companies differ in terms of their size, business model, and operating environment, and therefore the KAMs disclosed for unlisted companies may be vastly different from those disclosed for listed companies. This could provide an avenue for future research as the risk profile and business model for unlisted companies may differ significantly from listed companies, and therefore KAM disclosures may be viewed through a different lens.

Companies which are not primarily listed on the JSE do not need to adhere to the ISA's. ISA 701 may not be applicable to companies which are not primarily listed on the JSE. As such, companies not primarily listed on the JSE may have different disclosure requirements relating to their equivalent KAM disclosure standard. This illustrates an area of future research, where the differing disclosure requirements for KAMs may be compared and contrasted in their ability to portray relevant information.

KAMs must be disclosed for audits of listed companies, and may be disclosed if the entity in question is in the public sector (Reintjes, 2015a). Disclosing KAMs in relation to public sector companies would highlight the risks that public sector entities face and enhance the transparency regarding how resources are utilised in these companies, assuming that the costs associated with disclosure do not outweigh the benefits. In this way, KAM disclosures may be a method to restrict corruption and enhance the transparency of resource utilisation in the public sector. Accordingly, a future area of research could be in the public sector for KAMs. The benefit derived from KAM disclosures may not only be for private investors, but possibly a large array of stakeholders as KAMs may be used to ensure transparency of resource utilisation in the public sector, which may aid in ensuring governmental accountability.

The sample within the study constituted companies listed on the JSE, with the KAMs obtained for the 2017 and 2018 financial year ends. The lack of longitudinal analysis represents an inherent limitation in the study as KAMs were only mandated to be disclosed for listed companies with financial year ends on or after 15 December 2016. An area of future research could track the evolution of the KAMs disclosed for the same company across multiple time periods, to assess whether KAM disclosures have changed in their presentation and content to enhance the relevance of information portrayed.

With the comments above in mind, it appears that the value relevance of KAMs only related to KAMs disclosed in relation to the profitability and cash flows of a firm. This suggests that ISA 701 does appear to be conveying some form of additional relevant information for users, which could be used by the IAASB going forward in the post-implementation review of ISA 701.

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Appendices

A - Descriptive Statistics Table

Descriptive Statistics

	Range	Minimum	Maximum	Mean	Std. Deviation
Log10 Market Value Over Book Value of Equity	2.10	1.25	3.35	2.3552	.39725
KAM Number	6	1	7	2.71	1.221
Valuation of Financial Assets	1.00	.00	1.00	.0910	.21115
Valuation of Financial Instruments	1.00	.00	1.00	.1174	.20217
Valuation of Intangible Assets	1.00	.00	1.00	.1832	.27419
Valuation of Liabilities	1.00	.00	1.00	.0463	.13703
Valuation of Non-Current Assets	1.00	.00	1.00	.1974	.27706
Share Based Payments	.64	.00	.64	.0188	.09247
Taxation	.54	.00	.54	.0438	.10205
Related Party Transactions	.36	.00	.36	.0079	.04570
Consolidation	1.00	.00	1.00	.1005	.19110
Discontinued Operations	.59	.00	.59	.0102	.06311
Supplier Rebates	.72	.00	.72	.0180	.09251
Valuation of Inventory	1.00	.00	1.00	.0532	.15517
Going Concern	.31	.00	.31	.0049	.03607
Control Environment	.60	.00	.60	.0129	.06716
Valuation of Insurance Contracts	1.00	.00	1.00	.0469	.15726
Revenue	.58	.00	.58	.0476	.12889
Firm Size	8.88	19.50	28.39	24.4109	1.55000
Dividend Yield	72.00	.00	72.00	4.6015	7.15842
Earnings Change	4294.23	-2322.22	1972.01	2.7467	336.71619
Operating Cash Flow Change	14580.25	-1974.94	12605.31	65.6890	1032.61741

B – Test of Normality Table

Tests of Normality

	Kolmogorov-Smirnov			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Log10 Market Value Over Book Value of Equity	.046	160	.200	.995	160	.813

C – ANOVA Output Table

ANOVA

Model	Sum of Squares	df	Mean Square	F	Sig.

1	Regression	13.571	28	.485	5.512	.000
	Residual	11.520	131	.088		
	Total	25.091	159			

D – Multicollinearity Diagnostic Table

Multicollinearity Diagnostic

Model		VIF
1	KAM Number	1.689
	Valuation of Financial Assets	1.669
	Valuation of Financial Instruments	1.735
	Valuation of Liabilities	1.673
	Valuation of Non-Current Assets	2.269
	Share Based Payments	1.222
	Taxation	1.647
	Related Party Transactions	1.252
	Consolidation	1.698
	Discontinued Operations	2.425
	Supplier Rebates	1.378
	Valuation of Inventory	1.765
	Going Concern	1.242
	Control Environment	1.227
	Valuation of Insurance Contracts	1.771
	Revenue	1.519
	Firm Size	1.750
	Dividend Yield	2.098
	Earnings Change	1.225
	Operating Cash Flow Change	1.150
	Restatement	1.277
	Basic Materials	1.996
	Consumer Goods	1.634
	Consumer Services	2.947
	Health Care	1.455
	Industrials	1.797
	Technology	1.645
	Telecommunications	1.519

E – Multiple Regression Model Summary Table

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.735	.541	.443	.29654	1.581

F – Regression Significance Table

Regression Outputs

Model		Unstandardised Coefficients		Standardised Coefficients		
		Beta	Std. Error	Beta	t	Sig.
1	(Constant)	3.474	.490		7.087	.000
	KAM Number	-.011	.025	-.035	-.453	.651
	Valuation of Financial Assets	.340	.144	.181	2.361	.020
	Valuation of Financial Instruments	.206	.153	.105	1.347	.180
	Valuation of Liabilities	.334	.222	.115	1.503	.135
	Valuation of Non-Current Assets	-.185	.128	-.129	-1.447	.150
	Share Based Payments	.990	.281	.231	3.523	.001
	Taxation	.019	.296	.005	.063	.949
	Related Party Transactions	.385	.576	.044	.669	.505
	Consolidation	.115	.160	.055	.717	.475
	Discontinued Operations	.455	.580	.072	.785	.434
	Supplier Rebates	.697	.298	.162	2.335	.021
	Valuation of Inventory	.208	.201	.081	1.035	.302
	Going Concern	-.016	.727	-.001	-.022	.982
	Control Environment	-.751	.388	-.127	-1.936	.055
	Valuation of Insurance Contracts	.451	.199	.179	2.268	.025
	Revenue	.806	.225	.262	3.585	.000
	Firm Size	-.049	.020	-.191	-2.443	.016
	Dividend Yield	-.015	.005	-.271	-3.157	.002
	Earnings Change	.000	.000	.039	.591	.556
	Operating Cash Flow Change	-.000	.000	-.049	-.770	.443
	Restatement	-.010	.053	-.013	-.187	.852
	Basic Materials	-.043	.096	-.037	-.447	.655
	Consumer Goods	-.053	.114	-.036	-.469	.640
	Consumer Services	.252	.103	.248	2.444	.016
	Health Care	.297	.138	.153	2.149	.033
	Industrials	-.189	.097	-.155	-1.947	.054

Technology	.110	.173	.048	.638	.525
Telecommunications	.138	.141	.071	.975	.331

G – Multiple Regression Histogram

